# THE BUSINESS OF FINANCE

HARTLEY WITHERS

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BY

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# PREFACE

This Preface is written to the accompaniment of anti-aircraft guns, and the book itself was produced among the many distractions that war brings with it, even to a mouldy old civilian. Finance is a form of human activity that is essentially based on stedfast and well-ordered social conditions, and its work and progress are thus warped with especial violence by war and its barbarisms. Nevertheless the glare of war has thrown light on finance and brought out its strength and weaknesses in strong relief. When it ends, finance will need all its strength to face the great problems of rebuilding. The object of this book is to show where that strength lies and how it can best be used.

Hartley Withers.

Hampstead, February 16, 1918.

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# THE BUSINESS OF FINANCE

# The Business of Finance

## CHAPTER I

### INTRODUCTORY

MANKIND is now suffering from a raging fever, due to an ill ordered life and an overheating diet. It knows that it is going to get well again some day and in the lucid intervals of its malady it is making up its mind that this sort of thing is never going to happen again. The bad or stupid rulers who have brought it to such a pass are going to be requested to retire (this process has begun in Russia, but much more has to be done and in many countries); the world is going to be governed more sensibly, and with a clearer view of the appalling disasters to which man is liable owing to the devilish success with which he has perfected the means of destruction, unless his tendency to mutual destruction is exercised and chastened into brotherly good-will. Moreover the revelation of man's power, which his ingenuity in destruction has given us, is

going to be made use of, when once this fitful fever is overpast, for productive and constructive achievements such as have never yet been imagined. Better still, man is not only going to be better governed by his rulers and leaders. He is going to learn to govern himself better. For the war is showing us that the real strength of a nation is the strength and health and intelligence and sense of national duty of its individual citizens. It has brought home to the members of the nations in it, as nothing ever did before, that every man and woman counts and that it is the duty of each one to be as well fitted as possible in mind and body to play a part well in life's drama. The big fellows mouth and strut before the footlights, but it is the crowd at the back of the stage, with no "speaking part," that produces the real effect. In short, war has shown us how tremendous is man's power over nature, how prodigiously he has wasted it, what miracles he can accomplish if he makes good use of it, and finally that he cannot attempt to do so until he has improved his power over himself and learnt to keep himself in order.

These lessons learnt, there will be a great stride forward in moral and material progress. Progress, in fact, may be said to be just about to begin, when the present malady and the subsequent disorders of convalescence—which may be severe and long lived—have been overcome. Perhaps it may be said that the beginning has already been made, and that it dates from the day on which the United States,

by intervening on the side of Liberty, recognised that Progress cannot be confined to one nation, but must be world-wide if it is to go forward to its full triumph. This glorious vista of possible achievement that we can see dimly through the murk of war will only be reached by a great effort on the part of every nation and of every citizen. Progress does not happen of its own accord. It has to be worked for, or fought for, every day, every day by everyone who wants to win it. Chasing rainbows over the mountain tops is glorious fun for those who like it, and is, indeed, essential to progress, but it is hard work on the practical details of life that takes things forward; and in the great effort that has to be made every worker has to consider how what he is doing fits in with the great enterprise of bettering man's lot, whether his work is furthering it or hindering it; if it is furthering, how it can be improved; if it is hindering, how it can be reformed most thoroughly or buried most decently. Every form of man's activity has to be overhauled and bettered, and those that cannot justify themselves are likely to get short shrift. Kings and Parliaments, Churches and Schools, philosophies and sciences, employers and employed, producers, middlemen, officials, consumers, writers and talkers, all are being tested by the stress of war before the judgment of an exceedingly critical public, that, sick and sore with the sufferings that this cataclysm has brought upon it, cannot see why these horrors should have

happened and only submits to them in the hope that they will never happen again.

In the general refurbishing that is one of a few things that one can expect with confidence, Finance wlil come in for its full share of question and criticism. Like all other institutions it will have to justify itself. It is looked on with suspicion in the first place because its mysteries are "caviare to the general" as Hamlet says, and being little understood it is easily misunderstood; but also and chiefly because people are known to make a great deal of money out of it, and one of the things about which public opinion is now strongly, and justly, convinced is a belief that the distribution of wealth may and must be improved, and that superfluity and glut at the top of the ladder, with destitution and despair at the bottom, are conditions incompatible with true civilization. Finance has to justify itself as a beneficent and indispensable institution, showing that it earns its wages and does good work for the furtherance of economic progress, work that could not be done otherwise, or more efficiently, as society is at present constituted. At the same time, Finance has to consider the joints in its harness and take earnest counsel with itself concerning improvements in its machinery. That it will do these things I have no doubt. But everyone who works in its great world-wide factory will have to lend a hand, taking a wider view than hitherto of his responsibilities. Bankers, financiers, stockbrokers, bill discounters,

have to remember that earning a profit for themselves or for stockholders is not the beginning and end of their business, but that they are in charge of a big wheel in the great machinery of production and distribution of wealth, and so helping the progress of mankind to a better state of mind and body. Finance Ministers and tax gatherers have to remember that balancing this year's Budget, and getting revenue in with least possible soreness on the part of the tax-payers, and especially of their own political supporters, is less important than the question whether their measures and methods are tending to increase or hinder the growth of their country's wealth, and the world's output of goods.

This great conflagration, which has thrown a fierce light on so many things, has illumined with its glare many facts about finance which have hitherto been only dimly recognised. It has put Finance in its right place and that place is less important than many people thought. It is not the great ruling power that it was believed to be, but is merely the humble handmaid of Industry. Finance makes and handles claims to wealth and thereby assists in its production. But the wealth—the goods and stuff that man produces and the services that he renders to his fellows—is the really important thing in the world's economic problem. Without the workers who make the stuff and render the services Finance cannot, by the most ingenious jugglery, add one cubit to its stature. It is equally true that, as things are, Industry could not do a

day's work without Finance. But while Industry is essential to life, Finance is a piece of machinery which can be replaced if mankind decides that it might be improved on. We all remember how many people thought that a great war in Europe could hardly last many months because it would cost so much that it would not be possible to "find the money." Experience has shown that as long as the stuff necessary for war can be turned out, the problem of finding money (of a sort) is easy, because Governments with or without the help of the banking machinery can manufacture money as fast as it is needed and induce their peoples to pass it current to an apparently almost unlimited extent. In fact, as will be shown later, one of the results of the war has been a vast increase in the output of money, and a consequent rise in prices, because the output of goods did not keep pace with it, and one of the problems that Finance will have to face very seriously is the effect of this discovery on the minds of the unreflecting public, which is apt to think that multiplying money makes it richer, and to welcome schemes for enriching it by the simple industry of the printing press.

But if Finance is only the servant of Industry this is a position that puts its services in the very front rank for importance in the great move forward that is coming. If mankind is to be made better and the world a better place to live in, one of the first things to be done is to make mankind better off. This achievement will not by any means

solve the chief problem, because if, though generally better off, we continue to take sordid views about wealth as an end in itself and about the means by which it is fair to arrive at it, then nobody will be at heart more comfortable, and the economic relation of man with man will continue to be a bar to contentment and the attainment of the good life. But a great increase in material goods will be, at least, a help towards the creation of a better world. To the lofty philosophic soul the possession, or lack, of earthly goods is an irrelevant detail that has no effect on conduct. But most of us ordinary folk find it easier to be honest and kindly and contented if we are assured of a fair day's wage for a fair day's work, and are not compelled to live in chronic anxiety concerning the provision of our daily bread. When the burglar has burgled enough to secure a competence he is apt to settle down into a most respectable and exemplary citizen. What we have to do is make an honest living so easy to earn that man's higher faculties may have a better chance of being developed. As long as most of the inhabitants of the world live in a state of sordid insecurity there is little chance of getting the best out of them.

On the economic side of things, then, the problem that is before us is just the old problem, illuminated and simplified by the great discoveries that have been made in the course of the war. That old problem is the improvement of the output, transport and distribution of goods. War has taught all the

warring countries that they had a great store of energy available for production that had hitherto gone to waste, and that on the other hand many of the goods and services that used to be considered as essential to the full enjoyment of life could be foregone without any real sense of sacrifice—often, as in the case of heavy dinner parties and other forms of fashionable entertainment, with a very real sense of relief. If it had not been for the ever present thought of the awful loss of life among the flower of the world's manhood many people would have found life, under warfare's austere conditions, a pleasanter business than the old Vanity Fair round. At least this was so during the first two or three years of war, before the long strain of too much work, too much official muddling and too much waiting for good news had begun to tell on people's nerves. These considerations may surely have a great effect both on production and consumption. If their effect lives, it will mean that much more goods will be turned out and that production will be more cöncentrated on things that are really wanted. There will be fewer gamekeepers and more food growers, fewer flunkeys and more workers. In the matter of transport great economies and improvements have been effected in railway management, and the submarine has taught shipowners and shipmasters, and all who handle traffic at ports, lessons in efficiency that will be of lasting value. The distribution question—the division of the product—is one that bristles with diffi-

culties, which are likely to be great and serious when the war is over, and may, if not reasonably handled by all parties concerned, produce so much friction, and worse, that all the great opportunities for the improvement of man's lot that are now clearly visible may be lost, or made useless for generations. But at least the war has shown that only by harmonious and well organised work can the general output be increased, that that general output is the source, and the only source, from which all incomes are derived, that high wages and high profits can go together, and that ill-paid workers, working long hours under unwholesome conditions, are not efficient producers. That Labour will claim and get the better share of the good things of the earth to which it has long been entitled is, I think and hope, certain; and that this achievement will tend to healthier industry and a steadier demand for staple goods and more wholesome conditions in the whole body politic is an equally certain consequence, if Labour uses its victory wisely. Concentration on the problem of an increase in the general welfare, combined with a clearer perception of the fact that a great increase in the world's output of goods is the road to general comfort and content, may have effects that will astonish humanity.

This picture of a great development of economic activity and prosperity after the war assumes, of course, that the end of the war will be such that peace on earth and goodwill between men will be

assured if not for all time, as some earnest thinkers and workers are trying to secure, at least for some time to come. If the war ends with a peace based on hatred and vindictiveness and a desire to renew the struggle as soon as the fighters have recovered from exhaustion, then the best energy of man will be devoted not to bettering his lot, but to training the world's youth to the arts of destruction and to perfecting, by means of scientific devices, the horrible engines of warfare that have made the present struggle so appalling and so disgusting. In other words, man will devote his best energies to the art of destroying himself and all traces of such civilization as the ages have produced. The prospect is so terrible and at the same time so ridiculous that it would seem that both fear and a sense of humour should save him from such a fate. If not, then the great increase in output will take a different form and will be devoted to a multiplication of the same means of destruction.

In any case, it seems clear that man, with his faculties sharpened and his perceptions quickened by a struggle that has made nearly all members of the warring nations do more and think more, is going to be very busy, and will need in an increasing degree the help of the machinery of finance, possibly modified to meet new circumstances that cannot at present be foreseen. The chief activities of Finance are the manufacture and provision of currency and credit, the handling and distribution of

the capital that is saved by the community and put into the equipment of industry, and the collection and spending of the revenue of the nations and the raising of debts for any purposes that they choose to pay for by this means. The work of Finance is thus divided between private enterprise and public control. The provision of currency is done by both agencies, the Governments minting the coins, while notes are printed by State or semi-State banks (rarely by Governments), or by joint stock banks under more or less public control and patronage; and joint stock banks provide, as a general rule, the cheques which are the most commonly used forms of currency in the United States and Great Britain, the two countries with the most completely developed financial organization. The handling of capital, except when it is used by Governments for public objects, is left chiefly in the hands of private enterprise, and is managed by bankers, loan issuers, company promoters, bond-sellers and stockbrokers. The raising of revenue is a matter for which the Government is, in appearance, solely responsible, but its policy, especially in democratically governed States, is largely guided by public opinion. International payments and the machinery of exchange have hitherto been largely, almost entirely, in the hands of private enterprise, but war has made many Governments take a new and keen interest in questions of exchange.

It is possible that in the future the spheres of influence of public control and private enterprise will

be varied, and that the encroachments of the former on the boundaries of the latter that have taken place during the war may be preserved for some time after it, if not for all time. If so it will be at first sight a somewhat disastrous result of a war waged on behalf of liberty, that thereby the freedom and elasticity of private enterprise should be curtailed, and its activities taken over by the cumbrous and slow working State machinery. But it is possible that this may be only a superficial view, and that if the State can do certain things, hitherto done by private enterprise, more cheaply and efficiently, the cause of freedom, in the widest sense of the word, may be actually furthered by the development of State control. On these matters and many others, we have to try to rid ourselves of all prejudice. It is certainly true that a man controlled at every turn by the State can never grow into the fully developed being that can only be produced by freedom and personal responsibility. One who has never sinned because he has never been given the choice or chance of sinning is not therefore a good man. He is not a moral agent, but a machine. But if control and regulation in material things such as Industry and Finance have the effect of supplying our material needs with less labour and so leave us free for the development of our higher faculties, we may have gained a higher freedom by the sacrifice of a lower one.

But so far there is much to be said, at least in England, for the view that Government control

though necessitated by war has disgusted the public by its ineptitude. One of the reports lately issued on the question of Industrial Unrest in England made the following statement:

> "There is no doubt that one cause of labour unrest is that workmen have come to regard the promises and pledges of Parliament and Government Departments with suspicion and distrust."

This feeling of suspicion and distrust, which is by no means confined to workmen, has certainly shaken the public's belief in the efficiency of its governing machinery. On the other hand very great achievements have undoubtedly been wrought by this same machinery, such as the marvellous development of England's output of munitions and the creation of a great Army on a Continental scale in the course of a war in which her part, as a fighter on land, had been expected to be only a subordinate service to the cause that she espoused. It is not yet possible to tell whether the final verdict at the end of the war will confirm or reject the view that a development of Government control in Industry and Finance is desirable. All that we can be sure of is that, however man's activities are regulated. Finance, whether in private or public hands, has an immensely important part to play in a period of growth that is certain to be of extraordinary interest and may be one of quite undreamt of achievement.

Finance can only do the great task that lies before it, if it not only keeps its own machinery in the most perfect order, with a view to providing Industry with facilities on the soundest lines and at the lowest possible price, but if it also looks far beyond this obvious duty and always watches carefully to see that the effects of its work are in the best interests of mankind. The whole world is going to make a great effort to move things forward, and every worker has to remember always that his effort has to help. It will not be enough for Finance merely to make a profit for itself and sell credit cheap and make the handling of capital quick and satisfactory. It has to use all its great influence to secure that the credit that it creates and the capital that it handles are used for the right objects, promoting the general prosperity. Only thus can the best interest of Industry be secured, and the interest of Finance is directly bound up with that of Industry. Every time the effort of Industry is misdirected Finance probably suffers a loss and is certainly discredited in the public eye. Every time the promotion of Industry is accompanied by social evil, the ever watchful critics of Finance have a fresh item in their list of charges against it.

And there is an even wider responsibility that financiers like everybody else will have to consider if the effort of the twentieth century is to have anything more than a merely material effect. If we suppose that the most skillful and efficient use is

made of the revelation that has lately been given of man's power over nature, and that the supply of material goods is increased and distributed on a scale and with a justice and success that have never yet been thought of as possible, what then? What use is going to be made of this mighty improvement? On the answer to this question the fate of real civilization hangs. It is not enough that we should all be better fed, clothed and housed, if we make use of the greater leisure that more efficient production secures by wallowing still deeper in a stream of more freely supplied vulgarity. Old fashioned economists have been justly criticized because they seem to have thought that an increase in wealth was the sole object to be secured, and imagined that the process of competition would secure that this wealth would be equitably shared and well used. Experience has shown that this assumption was unsound in a world in which one of the parties to the industrial compact was in a much weaker position than the other, and the poverty of the manual workers and their lack of education often left them at the mercy of employers, who on the other hand believed that they were acting in the interests of the whole community by securing their labour at the cheapest possible rate. This error has now been left behind and it is recognised that ill-paid labour and consequent destitution are not only a stain on the civilization that permits them, but an economic evil that costs every nation dear in which they are found. It is now

admitted that it is not enough for a nation to be rich as a whole, which it can only be by producing a great mass of goods and services, but that its wealth should be well distributed, and that the goods and services should be devoted, as far as possible, to increasing the welfare of the whole community. But is it not necessary to carry this development still further and to recognise that the best distributed material welfare will not produce a fine race unless it is accompanied by a growth in our ideals and an improvement, which is needed in all classes, in our outlook on mental welfare?

When we consider the use that has so far been made of the great discoveries of the last century we see that there is very great danger even in the better future that is now seen to be possible that the marvels of science may be wasted on the purposes of vulgarity. Improved transport cheapened food, and so man spent more on fineries and futilities that were a terrible evidence of the taste of the purchasers. Cheap paper and cheap printing gave us a Press and a literature which did little credit to our discrimination; and the marvels of photography and the invention of the cinematograph were applied, with degrading ingenuity and success, to the purposes of sickly sentimentalism and blatant vulgarity. Such nauseating exhibitions only showed how little mankind's appreciation of what is good had kept pace with the development of his mechanical skill.

If the world is now to be made better, it will be

a great help, as has been shown, to begin by making it better off. But if in making it better off we lose sight, for a moment, of the real object to be gained, we shall have built only what Plato called a City of Pigs. In working for material ends we have to keep our minds ever fixed on the better ideal, of a world in which every citizen of every nation is fully supplied with all material needs and is also fully developed in mind, intelligence and character —kindly, courteous, clever and unselfish, and with that full appreciation of all sorts of beauty, in action, thought and perception, in which real civilization consists. Hitherto it has been thought possible only to give these attributes of mind to a minority of each community, the greater number having been left without real education and without leisure enough for full intellectual development. In Athens, for example, a minority of beings whose mental powers must have been on a higher level than those of any society that has existed since, was enabled by the slave labour of their dependents to lead a life of culture and refinement that has never since been paralleled. Now it is clear that if the right effort is made along the right lines, the use of machinery and improved industrial organization puts such a life, improved by all that man has since learnt from Rome's practical wisdom, from Christian teaching and from the works of great artists, writers and musicians, within the reach of the greater part of mankind. Will this effort be made? If one were to judge from

the attitude of the average Englishman, especially of those classes which are alleged to be educated, towards intellectual matters, there would seem to be little chance for real Progress. But perhaps a new spirit may arise if the war brings the right end, in the shape of a world made safe for democracy, and an all-embracing League of Nations, competing only in effort for the improvement of all. We may seem to have wandered far from the business and duties of Finance, but it is not so. No one can work well unless he feels that he is working not only for his own profit, but for a big thing to be secured by his work. If those who work the machinery of Finance see what a mighty big thing might be made of this world, for others who will be born after them, they will roll up their sleeves to their job with a very different spirit, and with very different results. The direction that human development takes depends chiefly on what the majority of hard-working people, in charge of important tasks, think is worth aiming at. Hitherto the object of our industrial leaders has been to produce a flood of cheap stuff and force it down the throat of an uneducated public by blatant advertising. The disgusting results of this degrading system are plainly visible in the sordid ugliness of our civilization which has defaced a world that is prodigal in natural beauty. Improved public taste with an improved ideal in Industry will, by slow degrees, transform the whole spirit and appearance of things. Working both for Industry and for

the public, Finance can play a great part in this transformation. Mankind is still but a flock of sheep, and in this matter of the use that it makes of its money, those with little money follow with pathetic stupidity the line left by those who have much. For obvious reasons the business of Finance is largely in the hands of men of wealth. The vulgarity of wealth has far less excuse and far more poisonous results than that of the poor, and there are many methods besides vulgarity through which wealth is habitually misused. If all who handle it and use it would recognise what might be made of this world if we really tried, the world would in a few generations be peopled by folk as different from the average man of to-day as he is from his Simian ancestor. It is certain that mankind's development will be, in the years to come, rapid beyond all precedent. Whether it will go upwards or downwards will depend on what is aimed at by those who count, among whom are those who work the machine of Finance.

# CHAPTER II

## THE PROVISION OF CURRENCY

FINANCE being the machinery by which money matters are handled the first thing to be considered, when we come to practical details of its business, is the money or currency that it creates. It is very necessary to be clear in our minds about the meaning of the terms used and to stick to this meaning. I regard money and currency as identical and to signify any article, whether made of metal or of paper, that is commonly accepted in payment for goods and services in economically civilized countries. It should be noted that this use of the word differs from that of some economists who restrict the word "money," some of them to actual coins, and some to legal tender, that is, those articles, whether coin or notes, which the State compels sellers and creditors to take in payment. I venture on the heterodoxy of a wider meaning to the word because I think it is more in accordance with the usages of ordinary speech and also because I think there is the still more important reason for it, namely, that the essence of money is its power to be exchanged into goods and

services, and that this power is just as effectively possessed by a cheque on a good bank, signed by a good drawer, as by any gold coin or gold certificate. It should also be noted that, in the jargon of the financial world, money has yet another meaning, namely, a short loan. "The money market" means the price at which banks will lend to good customers, and the price of money in this sense is the rate at which they will make such advances. Much confusion arises in the minds of the uninstructed from these various meanings given to the word. It is very difficult to write about money without using it in different senses on different pages, or even on the same page, but I hope throughout this book to confine it to the use that I have mentioned—namely, anything in the shape of coins or paper instruments that is commonly taken in exchange for goods or services.

Among these instruments the cheque, which I have already named as being heretically included by me in the term "money," is by far the most important in the volume of its utility and in its safety and perfection as an instrument of payment. It owes its being to the ingenuity of the financial machine as worked by private enterprise and to the confidence of the business community in the honest and sound conduct of that machine so worked. But, as it is only taken because it carries with it the right to the more primitive forms of money, it is better to consider them first, so following the course of currency history.

There is no need to go over that history in detail. Suffice it to recall that mankind began by exchanging goods and services against goods and services, and that much inconvenience was involved by being only able to make an exchange when two parties met, each of whom was possessed of an article which the other one wanted. So it came about that, when a tailor wanted boots but could not find a cobbler who wanted clothes, he would, if he could, take payment for clothes in some article which the cobbler would accept in exchange for a pair of boots. This process led to the adoption of some article of common utility (in the economic sense of the word) as a medium of exchange. Utility in the economic sense does not necessarily imply usefulness in the housekeeping, workaday meaning of the word, but only capacity for giving satisfaction. It is a fact that sometimes makes cynics chuckle, that the article of commonest utility in this sense proved to be the precious metals with their straight, simple appeal to human vanity, and the "utility" that they consequently possessed in decorating the person of the owner, winning the favours of the fair and propitiating primitive deities through the adornment of their temples and of their priests.

Perhaps it was just as well that man should have insisted on prettiness as the most essential point in the article that he was prepared to take, in the certainty of being able to pass it on when he wanted other goods or services. The amount of labour that

he has sunk throughout the ages in digging for the precious metals may some day astonish his more rational descendants, but it would have been even worse if some really useful article had been devoted to the purposes of a medium of exchange. Of the other advantages of the precious metals for this purpose—their ductility, durability and so forth—the text books on the subject have told at length. What we are concerned with is the fact that anyone who had a lump of gold or silver could, owing to the universal readiness to accept them, rely on being able to turn them into anything that he wanted within the limit of their buying power; and that this attribute clung to them throughout the ages as use and wont, and the power of convention and habit, confirmed it, until now a heap of gold, silver having taken a subsidiary position, is the essential basis of the most highly civilised banking system, and the paper money that is most favoured is that which is most readily and most certainly turned into gold on demand, if its holder so desires.

Gold still has value as a commodity for ornamental purposes and for use in dentistry, etc., but the demand for it for use as currency and as part of the basis of credit currency gives it a place by itself among commodities.

Owing to the inconvenience involved by having to weigh and test the metals whenever a purchase was made, the device was hit on of cutting them up into pieces of a definite weight and fineness, and so the art of coinage still further facilitated the

transactions of trade. It gradually became part of the business of Government to provide the citizens with stamped currency, the stamp being at once an official guarantee of genuineness and a protection against those who might make a living by scraping coins and then passing them on. But in the meantime private enterprise was already busy with the problem of providing commerce, especially commerce between nations, with some handier system of payment than the passing of heavy lumps of metal, coined or in bars, and it is clear from a passage in a letter from Cicero* that some system of making oversea payments by something like the modern machinery of foreign exchange had been developed before the Christian era, and the word used, *permutari,* was the Latin counterpart of the modern phrase. By 1470 the use of bills of exchange was common enough to be thundered against as a form of usury by Richard Porder, in a Whitsun Monday sermon at St. Paul's. "When," he said, "money is delivered by exchange betwixt place and place as from London to Hamborough, etc., to bee payde two, three or fower monthes after the deliverie thereof, and in respect of that time contracted and given any greater or more price upon the pound or hundreth pounds, than the price is at sight by the market, and more than the deliverer would have taken to have had payment with all possible speeds at sight (as they call it) that overplus or greater price taken for ye times for-

* Cic. *ad Att.* 12, 24.

bearance is usurie forbidden, and that deliverer is an usurer."*

It is not clear that the preacher quite understood the system that he was denouncing, but it is plain enough that the object of his invective was the system of payment for goods between London and Hamburg by means of bills of exchange payable two, three or four months after sight, a higher price being exacted in consideration of the time allowed to the buyer of the goods before he had to meet the bill. And so it is evident that the bill of exchange, of which, as will be shown, the cheque is a variation, was a much earlier means of payment than the bank note. It is an instrument of credit rather than a form of currency, in the sense in which I am using the word, and so its functions fall within the next chapter, but, as it had to be mentioned here as a matter of history, it is better to clear it up by giving its exact legal meaning—"an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determined future time, a certain sum of money to, or to the order of, a specified person or to bearer."

Since very large commercial transactions, especially in international trade, are settled every day in normal times by means of bills of exchange, it would seem at first sight that they ought to be

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* Quoted by Ellis Powell, *The Evolution of the Money Market*, p. 25.

included as currency. But they do not pass current in the hands of the general public. They are a highly specialised means of payment, handled chiefly by merchants and financiers, and so their volume does not directly affect the price of the retail goods on and by which the average human being lives. Many people spending large incomes go through their lives without seeing or hearing of a bill of exchange.

Some centuries after the invention of the bill of exchange the supply of credit instruments was increased by the discovery of the bank note, which is still a form of currency in the sense in which I am using the word. It is supposed to have arisen from a practice which grew up by which people left their coined currency for safe custody in the hands of the goldsmiths. The goldsmiths, as their stock in trade was of high value, naturally would have special arrangements for its safe custody, and consequently their customers were encouraged to leave their money in their hands in the expectation that it would be safer from theft. The next step in the process was that people who had deposited coin with the goldsmiths would, when they had to make a payment, instead of taking the coin out in order to make it, give their creditor an order on the goldsmith for the amount in question. These orders on the goldsmiths passed from hand to hand as currency and so fulfilled the purposes of coin. It must then have occurred to some unknown but epoch-making goldsmith that there was money to

be made and business to be done by supplying, to customers who came to them to borrow, not actual coin, but an order on themselves to pay coin. The goldsmith would trust that these orders would go into circulation and be out some time before they came in for payment; and from this time to the development of the modern note-issuing banker is a very short step.

The bank note is simply a promise to pay on behalf of the banker. When customers, at the note-issuing stage of banking, came to the bankers for monetary accommodation, they received from them, not coin, but a promise to pay coin. The banker lent money to the customer, and the customer, by taking the banker's promise to pay, at the same time, in effect, lent money to the banker, and so this curious system of currency arose, based on mutual indebtedness between two parties. As long as the loan was outstanding the banker received interest from his client for the advance, and at the same time, since the client received a form of currency which was accepted in payment by the rest of the community, he was able to go into the market for commodities and provide himself with any merchandise that he wanted for business enterprise, or for materials for building a ship, or any other industrial business that he had on hand.

It was obvious that such a simple means of making money by signing promises to pay was certain to lead those who practised it into temptation to practise it too freely, and the early days

of banking are a melancholy story of the ill effects of the over-issue of notes by bankers who forgot that, in order to keep themselves and their customers safe, it was necessary to have a stock of coin always in hand to meet notes that might be presented. The disasters that followed from the consequent over-issue of notes have been the theme of many romances and have also been the cause of much distress and disorder. And it is well known to everybody that the issue of notes by bankers was strictly regulated in England by Peel's Act of 1844. Since that date the Bank of England note has been practically a bullion certificate with a strict line drawn by the law for the amount of its fiduciary circulation, that is to say the amount of notes the Bank of England is empowered to issue with Government securities as backing. Over and above that line every £5 note has to have £5 in coin or gold bars behind it. The Bank Act did permit the Bank of England to hold one-fifth of the bullion held against its notes in silver, but this permission has never been put into practical effect, though the item "Silver Bullion," with a blank against it, is still to be seen in the weekly accounts issued by the Bank of England's Issue Department.

At the same time the note issues of the private and joint stock bankers of England were strictly regulated and their amount is now negligible in the total mass of the British currency.

Bank of England notes are very seldom seen in

actual circulation. They are largely held by the other banks as a reserve against sudden calls upon the currency. They are used occasionally in transactions such as a transfer of real property in which legal tender currency is demanded, and they are fairly frequently to be seen on racecourses when bookmakers are settling with their clients.

Notes, or promises to pay, are also issued by Governments, chiefly by those of economically backward countries, but in America the Civil War produced the greenback, and there are also gold and silver certificates issued against the deposit of these metals. In England the present war has produced a Treasury note for £1 and 10s. This happened at the beginning of the war when a severe banking crisis caused the public to hoard sovereigns and the banks to do likewise. The banks, when asked for money by their depositors, exercised their perfect legal right of paying them in Bank of England notes, and so the public found itself, in order to get small change, obliged to go on to the Bank of England and cash these notes. It was evident that a form of paper currency of a smaller denomination than £5 was required. Why the issue was made by the Government and not by the Bank of England we shall perhaps know some day when the war is over. At present all that can be said is that for the Government to act as an issuer of paper promises to pay is a quite new departure for England, and it is one which needs very careful watching, as it is already producing a crop of suggestions

that anything that the Government needs it can easily get by printing notes in payment for it. It is understood that these Treasury notes are not actually issued at present by the Government in payment for goods that it buys or for services rendered to it. They are, in fact, handed over to the banks, which pay for them by a draft on their balance at the Bank of England, at which the chief English banks all keep an account. Nevertheless, the final result is exactly the same as if the Government were to pay the notes out in payment for the purchases and, as we shall see later, the creation of currency in this manner has serious drawbacks attached to it.

Finally, we come to the cheque, which is now the most important instrument of currency in economically civilised countries.

Cheques were already in common use at the beginning of the nineteenth century, and it is very curious that, when the legislature took meticulous pains to regulate the note issue of Great Britain, it should not have observed that it was devoting all this trouble to regulating a form of currency which was already threatened by the appearance of a much more convenient and elastic rival. In fact, more than ten years before the passing of Peel's Act for the regulation of the note issue, it had been discovered by far-seeing people in the City of London that the note issue, which had hitherto been regarded as the corner stone of the banking edifice, was a comparatively unimportant ornament

of the building. This discovery had been put into very practical effect. As is well known, the Bank of England had been given what was understood to be a monopoly of joint stock banking in London by the provision that no society or partnership consisting of more than six persons should be empowered to issue notes in, or within 65 miles of London. It was believed that by this enactment banking in London would be reserved for the Bank of England and the private banks, owned by a small number of partners, and that joint stock banking could not raise its head in the presence of this monopoly. But, when it was seen that a note issue was not essential, and that the cheque was a much more useful and satisfactory machinery of banking, this monopoly was broken, and in 1834* the opening as a joint-stock bank of the London & Westminster Bank initiated a movement which has covered England with the branches of these and other important joint stock banks, having a head office in London and so enjoying no right of note issue but, nevertheless, doing a banking business on a scale which has in some cases dwarfed the figures of the great central bank round which they have grown, on which they lean and of which they are a strong support.

The legal definition of a cheque is "a bill of exchange, drawn on a bank and payable on demand." The advantages of the cheque are many. It can

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* Ellis Powell, *Evolution of the Money Market*, p. 304.

be drawn to the exact amount required. If drawn to "Order" it makes the endorsement of the payee necessary before its payment and consequently acts also as a receipt and a record of its payment. If crossed by the drawing of two lines across the front of it, it can only be collected through the bank of which the recipient is a customer; and if marked "Not negotiable," it throws upon the bank that pays it the onus of seeing that the title of the party to whom payment is made is good. By these protections it is a far safer instrument to use than a Bank of England note, since any thief who gets hold of the latter can turn it into goods in the ordinary course of business, so that the necessity for ensuring the safe delivery of a cheque is very much less than in the case of a bank note.

From the nature of the case it was impossible that the cheque should be made legal tender currency, that is to say that anyone to whom a debt was due could be forced to accept a cheque in payment. Legal tender in England is confined to Bank of England notes, Treasury notes, sovereigns and half-sovereigns up to any amount, silver up to £2, and copper up to 1/-. A cheque obviously could not be made legal tender because that would, in effect, have amounted to a guarantee by the Government that every cheque drawn would be good. Anyone who accepts a cheque in payment does so with the risk before him that the man who has drawn the cheque may not have an account at the bank at all, or may have overdrawn it if he has, and that the

cheque may be returned from the holder's bank with indications marked upon it that it is a worthless piece of paper. There is also the possibility, happily remote in these times, that by the time the cheque is presented for collection the bank upon which it is drawn may have failed. It is for these reasons that the cheque currency has been often left out from the definition of money put forward by economists. Nevertheless, it seems to me right to include it since, as a matter of actual practice, the great volume of commercial transactions is day by day settled by means of cheques, and they accordingly fit in with the wider definition of money that has been adopted for the purposes of this book.

Such, then, are the forms of money that are now used by economically civilised communities; bank notes, Government notes, cheques and coin.

In England, before the war, retail transactions, although even they were to a great extent settled by cheque, were still frequently paid in gold, and it was the custom of the average well-to-do citizen to carry several sovereigns and half-sovereigns in his pocket at all times. Since the war the place of these gold coins that used to circulate has been taken chiefly by Treasury notes and, to some extent, by a larger volume of silver total currency that has been minted. A very large number of sovereigns used also to be held in the vaults of the banks, to be used in case of a sudden demand for currency by their customers. Whether, when the war is over, we shall return to the use of gold in

circulation remains to be seen. It was often argued, in times before the war, that it was an extremely wasteful form of currency and that it would be better to circulate paper with a gold backing held by the Bank of England. The contrary argument, that the volume of gold in the pockets of the people was a reserve that would be very timely and useful if ever war or crisis arose, has been shown to be very true, and many monetary experts are of opinion that it is very desirable that this pocket-money reserve should be built up again when the war is over.

Of these various forms of currency it will be seen that one, the Treasury note, is manufactured directly by the Government; that the bank note is manufactured by the banker under strict Government regulation; that gold coins are minted and stamped by the Government as the gold bars are brought to the Bank of England and to the Mint to be coined; and that the cheque alone is manufactured by the bankers without any limit or restriction by law or Government regulation. By this interesting development the manufacture of currency, which for centuries has been in the hands of Government, has now passed, in regard to a very important part of it, into the hands of companies, working for the convenience of their customers and the profits of their shareholders.

It should be noted that in America this manufacture of currency by the banks is subject to Gov-

ernment regulation, since the Government imposes a legal limit upon the proportion of cash (that is to say, of specie and legal tender), and the deposits which the banks are liable to meet. The effect of this strict regulation has in the past been very far from happy since the result of it was that the cash reserves held by the American banks were useless in time of crisis. In England it has always been a maxim among bankers that the way to meet a run upon them is to pay out their cash with the utmost appearance of willingness and readiness. By this means the confidence of the public is restored and a run has over and over again been stopped. But, if the banker is forbidden to use his reserve because of the legal limit imposed by the Government, he is stopped from adopting the one means which experience has shown to be most efficacious in time of trouble.

It may perhaps be objected that the statement that the banks manufacture the cheque currency is incorrect, seeing that it is not the banks but their customers who are responsible for the creation of the banking deposits which represent the right to draw a cheque. But it seems to me that there is in this respect no essential difference between the bank notes that were formerly the currency of the commercial community and the cheque which has now taken their place. Both of them really are created by the action of the banks in making advances to customers, whether those customers be ordinary commercial borrowers or Governments

who issue securities, *e.g.*, in time of war, and place them with the banks.

In old times, when a customer went to a banker for a loan, the banker, if he agreed, handed him out so many of his own notes; now when a customer goes to a banker for a loan, the banker gives him a credit in his books, *i.e.*, adds to the deposits on the liability side of the balance sheet. It is true that the customer does not leave the deposit there but draws cheques against it which he pays to people to whom he owes money. But these cheques, if paid to recipients who also bank at the bank which has made the advance, would simply be a transfer within the bank's own books, and the effect of the transaction upon its balance sheet would be that it would hold among its assets an increase—if the loan was for £100,000—of this amount among its advances to customers; and on the liability side there would be a similar increase in the deposits. In the ordinary course of affairs, of course, it would not always happen that the parties to whom the cheques were paid would also bank with the same bank. They would pay the cheques into their own banks, whose deposits would be increased, and if we could look at an aggregate balance sheet of the whole of the banks of the country we should see that any increase in loans and advances would have this effect of increasing the deposits as long as those who receive these banking credits make use of them by drawing cheques against them. In the comparatively rare cases

where the borrower makes use of the credit by drawing out coin or notes from the bank, then the first effect would be that the bank in question would hold a smaller amount of cash among its assets and a larger amount of advances to customers. But even here the currency withdrawn would almost certainly come round again either to this bank or another from the shopkeepers or other people to whom the borrower had made payments. And so the cash resources of the banks, as a whole, would be restored to the original level while the deposits, owing to the increase at the credit of the shopkeepers and others who had paid the money in, would be added to by the amount of the advance originally made.

Exactly the same thing happens when, for example, in time of war the banks subscribe to loans issued by the Government, whether in the form of long-dated loans, such as the recent War Loan, or in the form of shorter securities, such as Exchequer Bonds, Treasury Bills, or Ways and Means Advances. The bank takes a security from the Government and pays for it with a draft on its balance at the Bank of England. It thus holds for the time being a smaller amount of cash at the Bank of England and a larger amount of Government security. But, as the Government draws on its balance at the Bank of England, the cheques which it pays to contractors and other people to whom it owes money are paid in by them to their banks, and so the banks have their cash restored to them

and the deposits of their customers, the contractors and others, are increased by the amount of the securities taken by the banks.

It follows that the common belief that a great increase in bank deposits means that the wealth of the community has grown rapidly and that people are saving money and depositing more with the banks is to a certain extent a fallacy. A rise in bank deposits, as a rule, means that the banks are making large advances to their customers or increasing their holding of securities, and so are granting a larger amount of bookkeeping credit, which appears as a liability to the public in the shape of deposits.

It may be objected that the deposits have to come first before the banks can make advances. Does this necessarily follow? Even if a bank were starting business to-day, it would begin with a certain amount of capital which would probably be paid to it in the form of cheques on other banks. By means of these cheques it would possess itself of a balance at the Bank of England and also, probably, a certain amount of legal tender cash in the form of notes, Bank of England or Treasury, and coin. It would then be in a position to make advances to a certain extent without having received any deposits, and its customers paying into it cheques on other banks, the right to draw which had been conferred by advances from them, would increase its deposits in the manner above described. And in the case of an existing bank, which already

has a large holding of cash in hand at the Bank of England, it is certainly in a position to make an advance without waiting to receive a further deposit first. It comes to this that, whenever a bank makes an advance or buys a security, it gives someone the right to draw a cheque upon it, which cheque will be paid in either to it or to some other bank, and so the volume of banking deposits as a whole will be increased and the cash resources of the banks as a whole will be unaltered.

It does not follow that this is the only means by which the deposits of the banks and the cheque currency by which they are passed from hand to hand can be increased. That will also follow if gold is imported, the effect of which will be that the party to whom it is sent will probably deliver it to the Bank of England and pay into his own banker a draft upon the Bank of England for its value. This will certainly be the process if the import of gold is in the form of bars. If it is in the form of sovereigns it may, very likely, be paid straight into the receiver's own bank. In either case the banker will hold a larger amount of cash, either in hand or at the Bank of England, and the customer will be credited with a like amount on his current or deposit account.

It may also happen, at times when trade is quiet, that coin and notes which have been in circulation may be paid into banks and accumulate there and so increase the amount of the banks' cash on the

one side and deposits on the other. But these movements are comparatively small in the total of banking figures, and the growth of deposits is chiefly affected by the action of the banks in making advances or increasing their holding of securities. In the ordinary business of life it does not happen to anybody except shopkeepers and other retail dealers to pay actual cash into their banking account. To take my own example as an average salary-earner, it has never happened to me in the course of the thirty odd years in which I have had a banking account to pay into it anything but a cheque drawn on a bank. It is very important that this function of the banks in increasing or decreasing by their own action the volume of bank deposits and consequently of the cheques that may be drawn against them should be clearly recognised. Money at the bank is just the same in its practical effect upon a man's state of mind as money in the pocket. Money in the pocket has no effect upon the price of goods. It is only when it comes out of the pocket and is exchanged for some commodity that it takes the form of an effective demand for goods. But the possession of money in the pocket is likely to stimulate the human craving to spend it, and it is exactly the same thing in the case of bank deposits which are potential currency, and become actual currency when they are used by the drawing of cheques upon them.

When once this fact is recognised, that the banks are still, among other things, manufacturers of

money, just as much as they were in the days when they issued notes, we see how important a function the banks exercise in the economic world, because it is not generally admitted that the volume of currency created has a direct and important effect upon prices. This arises from what is called the "quantity theory" of money, which has long been accepted as a truism by economists and, though it is still occasionally called in question, it can only, as it seems to me, be upset if it is complicated by irrelevant issues.

The quantity theory of money seems to me to be entirely clear and convincing to common-sense if we keep it sufficiently broad and simple, and express it by saying that, if the volume of money is increased more rapidly than the volume of goods coming to market, then there will be a general rise in the price of goods and vice versa. But, in order that it may be true, it is necessary that the word "money" should be taken in the broad sense in which I have used it, *i.e.*, all articles, whether coin or pieces of paper, which are commonly taken in exchange for goods. Failure to treat the problem on this broad and simple line constantly leads to confusion.

It has been argued, for example, by an economic professor who has lately written a very interesting book on the subject of money, that the quantity theory seems to have been disproved by the events of the present war. Professor Todd, in his *Mechanism of Exchange*, p. 166, remarks:

"It must next be asked whether the experience of the war had any effect upon the theory either in the direction of confirming it or otherwise. Certainly the facts are sufficiently striking, and at first sight they seem entirely incapable of any explanation which would be in the least consistent with the theory. For the facts are that the general level of prices has risen since the war beyond all experience in modern times, while the gold output has remained practically as it was before the war."

Professor Todd is by no means the first who has complicated the simplicity of the quantity theory by considering that it can only be shown to be true if a direct relation can be shown between the quantity of gold and the movement of prices. It is at all times easy to question this contention, because the quantity of credit created by bankers does not necessarily vary exactly with the amount of gold that is available for its basis, and in war time, when for patriotic and other reasons gold can be husbanded for war purposes and credit can be created with much less attention than usual to the question of a gold basis for it, the relation between gold and prices is more than ever illusive. Nevertheless, if we take money in the wide sense in which it is used in this chapter, as including all forms of currency, and especially cheques, that are taken in payment for goods, it appears to me that the quantity theory is so true as to amount to a truism. It merely comes to this:—Money is created faster than goods; there is more money in the

hands of the community that is purchasing the goods; their purchasing power is consequently increased while at the same time the quantity of goods to be purchased remains stationary or is diminished. That a rise in prices should follow from such a process seems to be as inevitable as anything in economic science.

It is, however, often contended that a rise in prices, for example during war time, would have happened anyway owing to the increased demand for certain commodities, and that the increase of currency followed this rise in prices, being necessitated or justified by it, and that therefore the rise in prices came first and caused the increase in currency.

This argument appears to me to ignore the fact that a general rise in prices is only possible if there is a general increase in effective demand, a demand that is to say on the part of people who have money in their hands with which to bid and to buy, and that this increased demand cannot happen unless there is an increase in available currency. As John Stuart Mill says, "The demand which influences the prices of commodities consists of the money offered for them."* Unquestionably the changes in consumption that war brings about would, without any increase in currency, have produced a rise in the prices of certain commodities. Food, for example, being consumed on a much more generous scale

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* *Political Economy*, Book III, Ch. xii, 2.

by soldiers in training or in the field than it was by the same men in civil life, and a more generous diet being also required by the industrial population owing to the strain on its energy in the production of munitions, would certainly have risen in price on or soon after the outbreak of war. But, if there had been no accompanying increase in the currency, it surely would have happened that the larger volume of money absorbed by the purchases of food at the higher prices current would have withdrawn the amount of money available for purchases of other goods, and that consequently a fall in their prices would have compensated for the rise in the prices of food. If this be so, then a general rise in prices, such as has been seen during the course of the present war, could only be accounted for by the fact that all the belligerent Governments have been, with or without the help of the banking machinery of their countries, increasing very rapidly the use of the printing press and the activities of the bankers' ledger clerks who chronicle the creation of banking credit.

By this process the said belligerent Governments were enabled to collect, either from the banks or from the pockets of their citizens, large amounts of gold which were no longer needed for currency and to ship them to neutral countries, so that an enormous bloated balloon of world-wide inflation was created, since in all countries of the civilised world the same phenomenon was visible of an increase in currency, either produced by the printing press or

bookkeeping, or by abnormal imports of gold, and at the same time either a diminution in the production of goods owing to the absorption of manpower into the armies, or, in the neutral countries, an increase in production, which, being hampered by the difficulty of obtaining raw material, did not keep pace with the increase in the amount of currency available.

It may be that it is dangerous to simplify the quantity theory too severely. It is sometimes possible to arrive at simplicity and clearness by ignoring facts which ought to be taken into account. We must not forget that an increase in currency will have no effect upon prices if the currency is not turned over; that money in our pockets or at our bank as balances, though it has a psychological effect upon our readiness to spend, has no actual effect upon prices until we make use of it in order to buy, and that, on the other hand, although it may be said that the quantity of goods coming forward for consumption is to a certain extent limited by the productive power of the country and of its neighbours with which it deals, yet there are at all times in all countries a great mass of goods, in the widest sense of the word, such as houses and securities, which may at any time come into the market.

It seems to me, however, that these considerations, though they must not be lost sight of, do not in any way shake the truth of the quantity theory as a broad principle. If a larger quantity than usual of the commodities, such as houses, which do

not often change hands, come into the market, that would simply mean that the supply of goods for sale would be thereby to that extent increased for the time being, and that these sales would check and perhaps reverse any rise in prices that had previously been caused by currency inflation. But, if we keep our attention fixed hard upon the fact that, however much a man may covet and desire to possess an article that he sees for sale, he cannot exercise any economic effect upon it unless he produces some form of currency wherewith to purchase it, it then, surely, follows that a general rise in prices can only happen if this power to purchase is increased by an addition to the volume of currency.

If, then, the quantity theory is, as I believe, broadly true, we see how great is the responsibility of the bankers as manufacturers of currency, seeing that by their action they affect, not only the convenience of their customers and the profits of their shareholders, but the general level of prices. If the banks create currency faster than the rate at which goods are being produced, their action will cause a rise in prices which will have a perhaps disastrous effect upon the lives of those who are struggling with a bare margin of subsistence, and may produce industrial unrest with social and political consequences which may be far-reaching and disastrous.

In normal times, the process of over-production of currency, or inflation as it may for short be

called, is usually corrected if it is confined to any particular country, because the effect of it is to raise prices in that country above the world level and so to increase imports into it and check exports from it. By this process, in the first place, goods pour into the country and so check the disproportion between goods and currency, and a further consequence is that the course of the exchanges goes against the country in which inflation is practised; gold is drawn away from it, and an automatic remedy is thus very opportunely prescribed for the disease by the beautifully balanced working of the mechanism of exchange. But as it is probably usual that the state of mind in which bankers over-produce currency is general throughout the civilised world, which is now knit by the telegraph into not only one great market but into one great mob, swayed at the same time by similar influences, similar optimisms and similar fallacies, it is more than likely that this nicely balanced process of correction, which applies itself readily enough if inflation is only practised in one country, will fail to work when inflation is busy all over the world.

Since, then, variations in the quantity of currency have these widespread effects, it is a matter which bankers have to consider seriously, how far it is possible for them to apply some scientific regulation to the volume of currency, and whether it is possible to modify the evils that follow wide fluctuations in prices by some such regulation.

It may be observed that, on the whole, the effect of a moderate and steady process of inflation acts as a tonic for the economic body. If it be true that a slight excess of currency creation ahead of the production of goods causes a slight and steady advance in prices, then we see that it is exactly the state of things required in order to stimulate the activity of production, give manufacturers and merchants confidence in the course of prices and so increase their readiness to indulge in fresh enterprise, open up new fields of production, pay good wages to their workers, and so at the same time increase the volume of goods for consumption on which mankind's welfare depends and improve their distribution, which is so important to the general contentment. All these things could be secured if we could be sure that all new currency created by bankers was placed at the disposal of genuine producers who could make use of it in order to increase the volume of goods, and so help to maintain equilibrium between goods and currency.

Such a state of things would be in many ways beneficial, as is shown by the fact that it has been seriously argued by a great historian that the decline and fall of the Roman Empire was really due to the lack of precious metals and the consequent fall in prices which took all the heart out of the industrial enterprise of the traders and merchants of those days. It is perhaps a little difficult to believe that a mere deficiency in what is, after all, only a piece of mechanism in exchange can have

had so wide-reaching an effect; but it is easy enough to understand that a steady fall in prices, continued over long periods, would produce a state of very great depression among those responsible for industry, and that few would be inclined to open up fresh productive ventures with the chance before them that, before their ventures could produce anything ready for the market, the market price would have run away from them and left them with a balance on the wrong side of the ledger.

There can be no question that rising prices stimulate industry while falling prices discourage it. Rising prices put money into the pockets of producers and those who are responsible for keeping the wheels of industry spinning, and they take it out of the pockets of the *rentier* class living on the interest of saved or inherited money. Between these two classes there is no doubt as to the interest of which should be encouraged from the point of view of human progress. But we have to remember that the *rentier* class, though not apparently as useful as the active producer who is putting all his energy into making goods for our consumption, is nevertheless essential to the progress of industry. If the course of currency creation is such that a man who is living on invested funds gets a smaller and smaller share of the world's goods in return for the money that he receives in interest, then the process of accumulation and the saving of capital will be checked, and it will be shown in a later chapter how

this process of saving is necessary if the progress of industry is to be maintained.

There is another highly important consideration attaching to this question of a general rise in prices produced by currency inflation, and that is the fact that experience shows that the movement of wages does not as a rule keep pace with the movement of prices but lags behind them, usually by an interval of three to six months. As long as this is true, falling prices are an advantage to the working classes and rising prices are against them, and so rising prices tend to produce dissatisfaction and industrial unrest. It is well known that, in England, for some ten years before the present war, though money wages had slowly risen, the rise in prices had gone faster, that the working classes were highly dissatisfied with this state of affairs and that, if the war had not happened, there was every appearance of an outbreak of industrial strife on a scale that had never before been witnessed. It is possible that, as the organisation and education of the working classes progress, they may be able to correct this tendency for wages to lag behind prices when prices are moving upwards. But, as things are, the fact that rising prices, if continued too far and too long, tend to check accumulation and to produce industrial unrest, is a very serious drawback to put on the other side of the account as against the encouragement that they give to the energetic producer and to those who benefit from the extra profits produced by higher prices.

This being so, the ideal to be aimed at would seem to be steadiness in prices; in other words, it is the business of finance to consider whether it cannot regulate the general level of prices by somehow maintaining more or less constant equilibrium between the production of goods and the creation of currency. If all currency creation consisted of bankers' credits, then it would clearly be possible for an ideal banking system, worked by ideal bankers, for the convenience of ideal customers, to produce the required equilibrium or very nearly. If they satisfied themselves every time that they made an advance that the credit so created was going to be used in increasing the production of goods, the problem would be in a fair way to solution. But, in the first place, the relations between bankers and customers do not at present permit this simple process of regulation, and, in the second, as we have seen, the manufacture of currency, though to a great extent in the hands of the bankers, is subject to conditions over which they have no control. One of these conditions is the amount of gold available. When the production of gold is rapidly increased, not only is there so much extra buying power in the form of coins struck from the gold, but, since the increase in the gold available enables bankers to issue a very much larger amount of paper credit against it, it follows that activity on the part of gold miners has, or may have, an effect upon world prices which is much greater than the actual addition to currency which they themselves take out of the bowels of the

earth. It seems at first sight absurd that at this stage of our economic civilisation such an important matter as world-wide price movements should depend upon the pace at which a certain kind of metal is dug out by miners; and in these times, when there s a general tendency to question and criticise all human institutions, the dependence of man on gold as an essential part of the machinery of finance is naturally scoffed at by the sceptical and pointed to as a clumsy survival of medieval or even neolithic barbarism. It has even been suggested that the experience of the war may lead the way to a general demonetisation of gold and the substitution for it of a scientifically regulated currency.

It seems to me that the financial and industrial problems which will face us when the war is over are quite serious and difficult enough without complicating them still further by an attempt to institute a currency reform or change which might have consequences quite unforeseen. It is the uncomfortable habit of economic changes to run away with those who introduce them and produce results often quite contrary to the intentions of the reformers. Gold has got such influence upon the human mind, owing to centuries of habit and convention, that it is still regarded as the one commodity which can always certainly be relied upon in times of acute crisis. Even now, when it has been made clear that it is everyone's duty to pay in all the gold they possess through their banks, so that it may be used for war purposes, I have been lately told by many

quite reasonable people in England, among them an economic professor, that they are still keeping a few sovereigns locked up in case of anything that may happen. I believe this prejudice in favour of gold to be so ingrained that any attempt to try to hasten the process by which substitutes for gold are used, these substitutes being mere tokens issued by a Government with no promise to pay gold behind them, might have disastrous effects. It will be a great economy if the day ever comes when peoples have sufficient confidence in their Governments and in their bankers to feel sure that pieces of paper issued by them will always be taken in exchange for goods without any intermediate process of exchange into gold and the exchange of the gold into goods. But it seems to me that it will take about a century of economic education before we can arrive at that ideal and that if in the meantime we try to take short cuts we might find ourselves landed in a very uncomfortable position.

An obvious first step would be to cease the coining of gold for internal use and to make credit instruments convertible into bar gold for purposes of international payment.

But it is the business of those who are responsible for the machinery of finance, in the first place, to work it in such a manner that equilibrium between goods and currency shall be as far as possible maintained, so that the course of prices may be kept steady and that the even progress of mankind's economic development may be as little as possible

disturbed by wild fluctuations from periods of excessive optimism and boom with their inevitable reactions into depression, occasionally intensified by panic.

# CHAPTER III

## CREDIT

In the last chapter it was shown that the most important of the modern forms of currency, namely the cheque, is, in effect, manufactured for the use of its customers by banks; and, further, that since the volume of currency has an important effect upon raising prices, the extent to which currency is thus created is a responsibility which has to be seriously considered by those who work the financial machine. This manufacture of currency is worked through the granting of credit, and credit may thus be defined, for the purposes of this enquiry, as the process by which finance makes currency for its customers. As we saw in the last chapter, deposits, which are potential currency, as they carry with them the right to draw a cheque, are produced largely through the loans, discounts and investments made by bankers. In the ordinary sense of the word, credit usually carries a wider meaning, covering any kind of arrangement by which a seller takes from the party who wishes to secure goods from him some form of engagement that payment for the goods will be made at a future date. In

this sense of the word it is a credit operation when a shopkeeper sells me a suit of clothes on the understanding that he will send me in an account some months later in the expectation that I shall, at some time or other after the bill has been presented, pay for it. Operations of this kind, however, though of considerable importance in the volume of commercial transactions, do not come within the purview of the machinery of finance. Credit, in the truly financial sense, is, as described above, the arrangement by which the financial machinery gives its customers facilities which enable them to provide themselves with currency to go into the market and buy commodities, securities, or anything else that they want or think they want.

In order to see more clearly the method by which these arrangements are made, let us look at a balance sheet of what was then the biggest English bank at the end of June, 1914, before the war period began to complicate and expand banking figures. On the liabilities side we find the following items:—

| | Millions |
|---|---|
| Current, Deposit and other Accounts.. | 107 |
| Bills accepted or endorsed........... | 4 |
| Capital ......................... | 5 |
| Reserve ......................... | 3½ |
| | 119½ |

The Assets were as follows:—

| | Millions |
|---|---|
| Cash in hand and at Bank of England.. | 18 |
| Liabilities of Customers for bills accepted or endorsed................ | 4 |
| Premises ........................... | 3 |
| Investments ......................... | 13 |
| Cash at call and short notice........... | 10½ |
| Bills of Exchange.................... | 14½ |
| Advances to Customers.............. | 56½ |
| | 119½ |

If we examine this balance sheet we see that the bank's own capital and reserve amount to 8½ millions and that it has accepted Bills—a process which will be explained later—to the extent of 4 millions, and that the rest of its liabilities consist of the principal item, Current and Deposit Accounts, for 107 millions. The other side shows that it has made advances in the shape of Cash at call and short notice, Bills of Exchange and Advances to Customers, for a total of 81½ millions, and that its investments amount to 13 millions; so that, against its deposits of 107 millions we find assets which are, in one form or another, loans and investments amounting to 94½ millions.

Examining more closely the process by which these loans and investments have been made, we see that the chief item in the process is the big

item, Advances to Customers, of 56½ millions. This item explains itself, being obviously loans made to the customers of the bank against any collateral pledge that the bank may think adequate or possibly, in some cases, merely against the good faith and known high financial position of a customer.

What the bank describes as "Cash at call or short notice" consists in fact of loans to bill brokers and stock brokers, who finance, by credits granted by the banks, their holdings of bills of exchange, if bill brokers, or the holdings of securities, in the case of the stockbrokers, which their clients or themselves have purchased in the hope of a rise in their prices, or for some other reason. Loans to bill brokers are closely connected with the subject of the bill of exchange, which has to be now explained as a highly important stone in the financial edifice. Originally, as all men know, a bill of exchange was an order drawn by a seller of goods ordering his buyer to pay the money due for the goods to himself, the seller, or to the order of any party to whom the seller wished the money to be handed. A. sold goods to B. and drew a bill upon him instructing him to pay the money to him, A., or to any party he might name. The original bill was thus simply a memorandum, sent with the goods, instructing the buyer as to how he should pay for them.

Since B. might, in the ordinary course of trade, wish for time before handing over the money, so that he might be able to dispose of the goods to retail

customers, the custom rose of instructing B. to pay the money not at once but at some date, usually two to six months after sight of the bill of exchange. When B. recognised that the order to pay was one which he was bound to meet, he intimated the fact by "accepting" the bill, that is to say writing his name across the front of it and adding the date of acceptance. The date of acceptance was thus the date at which the bill was first sighted, and so the life of the bill, two or six months after sight, would be calculated from this date of acceptance. The bill, being thus accepted, could be turned into cash by A. or his agent in the place in which B. lived, through the means of the discordant market, in which bills drawn and accepted by people of good financial standing could be sold for cash at a discount on the face value of the bill calculated according to the current rate of interest.

For instance, if A. drew a bill on B. for £1,000 six months after sight, and if A. and B., especially B., who was first liable to meet the bill, were men of good standing, somebody would be found who would give A. or his agent £1,000 the day after acceptance, less a discount rate which, if we suppose it to be 5 per cent. per annum, would mean that £25 would be taken off the face value of the bill, and so A. would immediately become possessed of £975. By this means A. would get his money at once, B. would get the goods and could work them up for sale, if they were raw materials, or could dispose of them to retail customers and grant them

a certain amount of credit, and the holder of the bill had a temporary investment which was valuable according to the standing of the parties upon it, and which carried the additional advantage that on maturity the money had to be paid.

Since it was difficult for dealers in bills to keep themselves continually advised concerning the standing of merchants in whose acceptance they dealt, the custom arose for certain eminent financial houses to specialise in this business of acceptance, accepting bills on behalf of people whose financial eminence was not secure in return for a small commission. They thus, by writing their names across the front of bills, gave them first-rate standing, enabled the customers who had paid them a commission to secure the advantages of the gilt-edged security which they had given to the bill, and provided those who bought the bills with an even more unquestioned security than that of the ordinary merchant.

In England it has long been the custom for the banks to take part in this business of acceptance, and we saw in the balance sheet given above that there was an item of 4 millions, "Bills accepted or endorsed," against which the bank held as an asset 4 millions in the form of the liability of customers for bills accepted or endorsed. This means to say that this particular bank had allowed customers of its own, probably importing merchants, to buy goods chiefly from abroad and instruct their sellers to draw bills against the shipment of the goods,

not upon the importing merchants but upon their bank, so giving the bank's eminent standing to grace the bills so drawn. The customer, however, was himself liable to put the bank in funds to meet the bills so drawn before they fell due.

If we take the case of a Liverpool merchant importing cotton from an American seller, and instructing the American seller to draw on a London bank bills payable 60 days after sight, then the Liverpool importer, having in the meantime disposed of the cotton, would have money in hand to pay into the bank to meet the bill before it fell due. The bill would be drawn by the American seller, sold by him to an American bank, shipped by the American bank to its agent in London to be presented for acceptance, and then sold in the London discount market. This selling of the bill would take place through the medium of a bill broker, who would buy it either to hold himself for the time being, or to sell immediately to one of the great London bankers which are ultimately the holders of a large part of the best bills that come to London. As we see in the balance sheet given above, this particular bank has a holding of bills of exchange amounting to 14½ millions. Thus the banks provide the money which these bills of exchange produce either by lending it to bill brokers under the item "Cash at call and short notice," or by actually investing it in bills of exchange under the item so expressed.

The acceptor of the bill does not in the normal

course of business find any money at all. He puts his name upon the bill, indicating that he will pay it at a certain date, and trusts to the customer to whom he has lent his name for a consideration to provide him with the money in order to meet the bill. If the customer fails to do so, he then has to meet it out of his own funds. The credit produced by the discounting of the bill is found by the purchaser of the bill, in most cases either a banker or a bill broker to whom a banker has advanced the necessary funds.

The creation of credit is thus seen clearly to result in the manufacture of currency whenever the banks buy bills of exchange for investment, or make an advance to bill brokers in order to enable them to carry their stock of bills. In either case the banks give somebody the right to draw cheques. It should be explained that the bill brokers act largely as merchants in bills of exchange, buying them wholesale as they come forward from the agents of the foreign exporters and gradually selling them to the banks to meet the requirements of the latter in the matter of names and dates.

When a bank makes an advance to a stock broker to assist in the process by which securities are financed that have not yet found an ultimate home, the result is exactly the same. The bank makes an advance on the pledge of the securities held and of the standing of the stockbroker, and the stockbroker is thus enabled to pay, on behalf of his customer, the

seller of the securities, or the issuing house which is bringing out a new security.

The same result, in rather a different form, happens when a bank makes investments on its own account. It pays for the securities bought, probably with a draft on its balance at the Bank of England, whereby its holding of cash at the Bank of England is reduced and its holding of securities is increased. The seller of the stock, to whom it pays the cheque, pays it probably into some other bank, which thus has its cash at the Bank of England increased and has a corresponding increase among its deposits on the other side of the balance sheet. There has thus been, in each case, an increase in deposits through the operation of the bank in lending, discounting or investing. If we can imagine all the banks suddenly selling all their investments and bills of exchange and calling in all their advances, the process could only be brought about by the cancelling of deposits, their own and one another's. And so it becomes evident, as before stated, that the deposits of the banks which give the commercial community the right to draw cheques are chiefly created by the action of the banks themselves in lending, discounting and investing.

Since, then, it thus appears that credit is the machinery by which a very important part of modern currency is created, it will follow that it should as far as possible be chiefly placed at the disposal of those who are producing goods, or are going to produce goods, because, as has been shown, if cur-

rency is created more rapidly than goods are produced, the result is a rise in prices which, if carried too far, is likely to have evil effects. It is the business of finance to try to maintain something like steadiness in prices by aiming at equilibrium between the manufacture of currency and the production of goods. There are nowadays very many schemes for making mankind rich and happy by increasing the amount of money in its pocket; and the experiences of the war, in which governments with the assistance of their bankers have greatly increased the supply of currency—and so have made huge expenditures an apparently simple matter—are only too likely to tend to the adoption of schemes of this kind when the war is over, and all kinds of dangerous short-cuts may be tried to find a way through the difficult problems that will then arise.

All who are interested in the sanity and sense with which finance is conducted will have to do their best to impress on those whose economic education is deficient that you do not make people really any better off by plastering the world with paper promises to pay, but that what does mankind real good is stimulating production of good things to put into its stomach, stout clothes for it to wear, good houses for it to live in, and sound education to make it see straight in matters of finance and in doing its duty to its neighbour. It is only by producing as fast as possible a great increase in the store of good things to be enjoyed that we can make humanity better off, and this is the problem to which

finance has to address itself and never to lose sight of in working its machinery. Increased production, with an improvement in distribution, of good things to make people healthy and contented is the way to a better world on the material side. It is necessary to insist on these platitudes because producers and merchants—especially merchants—have rather a prejudice towards the opposite view. The thing that they are most terribly afraid of, and from their own point of view with good reason, is the possibility of a glut of goods—goods in their warehouses that they cannot sell without so serious a reduction in the price that all their profit is gone, and that the profits of prospective producers might become so problematical that production would be checked. It is this fear of glut which gives such an uneasy feeling to merchants and producers, which is just as dangerous as the opposite tendency to inflation if currency is manufactured too rapidly.

The cure of glut is obviously to be found through a better diffused and better organised buying power on the part of humanity, and also by a better concentration of industry upon such goods as would be certain of a market whatever may happen to changes in fashion. Better diffused buying power is obviously secured most simply by a steady rise in wages of manual workers and other comparatively ill-paid servants of society, and also by their better education concerning the things that may be bought out of their surplus, if any. At present industry, in the widest sense of the word, devotes much of its

time, energy and money, which it afterwards gets back from the public, to forcing upon the public goods which it thinks the public ought to want just because it has produced them and wants to sell them.

This process is carried out by the enormously costly system of advertisement, circularising and other forms of touting which now absorb so much of the energy of the sellers of goods, whose services put perhaps as much into the ultimate cost of the goods as all those of the original producers of the raw material and of the manufactured article. If we could only train mankind to know exactly what it wants to buy and could find some system by which it would notify these wants in advance, the economy in production from the elimination of the advertiser would be enormous, the profit of the real producer would be increased, while the price to the ultimate buyer could be reduced. Industry would be to that extent less a gamble and would go back to something like the medieval basis when each man ordered in advance the goods that he needed, which were then manufactured for him by the armourer, or the tailor, or the shoemaker, or whoever it might be, without any question of manufacturing on the chance of inducing a buyer to take over goods by hiring someone to force them down his throat. I do not wish to be understood as urging that we should really go back to a system of this kind in all its entirety, but if we could aim, by means of co-operative purchase, education, or otherwise, at some sys-

tem by which demand would be more reasonable and more certain, the whole process of manufacture and distribution would be simplified and strengthened, and the business of the financier would be made much easier.

If, then, fear of glut is a constant terror in the mind of the merchant and the producer, this does not seem to be a sufficient reason against taking all measures to stimulate as far as possible the production of goods, since it has been shown that it is only by the production of goods that the general welfare of mankind can be increased and since the machinery of finance will be tested by this question, whether it is really serving the general welfare of mankind. There cannot be a real glut of goods in general until all man's material wants are satisfied. Goods are made to be exchanged for goods, and as long as their production remains fairly level the terms on which they exchange will be fairly level and they will absorb one another, so to speak, by their mutual demand. More boots produced will absorb more wheat grown. It is when industry makes lopsided progress and the output of boots grows faster than that of wheat that glut arises.

There has of late been a good deal of question in England concerning the extent to which the banking machinery has assisted production, and it has been contended that more efficient machinery might be provided for this purpose. On the whole it seems to me that these criticisms of the efficiency of bank-

ing in this country largely fell flat. It was certainly shown that there was room for machinery for doing things which banks were never meant to do, such as the examination, nursing and preparation of financial enterprises of more or less doubtful possibility which might, with financial assistance, develop into useful industry. It is not the business of banking to take risks of this kind in view of the great liability which the deposits entrusted to them by the public thrusts upon them. There certainly was room for some kind of financial crêche in which interesting but possibly rickety infants might have their first toddling footsteps guided, and on this subject and on the whole question of the machinery for company promotion there will be more to be said in a later chapter. It is the business of the banks to do all that they can in their power to assist production, but, at the same time, never to forget that that big item of "Current and Deposit Accounts" is their first responsibility. Nevertheless they can do much, by the bills that they accept, the bills that they buy and the loans and advances that they make, to regulate the machinery of finance in such a way that production shall have the first call upon its output, that is to say of the currency that it creates for its customers. On the whole there can be no doubt that production has no fair charge of neglect to lay at the door of the banking machine. Nevertheless there is no harm in laying stress upon the importance to the banking world of keeping this object always in view. It may lead to misappre-

hension if the banks are thought to be too closely connected with the machinery of stock exchange speculation and the machinery of speculation in the produce markets. If ever banking is called upon to render an account of its stewardship, it can do so most effectively by showing that it has used its great power of creating currency in such a way that it has been devoted chiefly to the production of more goods for the enjoyment of man, and that the equilibrium between goods and currency, which a former chapter has shown to be desirable, has thereby been furthered or secured.

## CHAPTER IV

### CAPITAL

In the minds of many people the line which divides credit from capital is hazy. This is largely owing to the exasperating habit of economic and financial jargon which constantly insists upon talking about different things by the same name. Credit operations are often spoken of as including all the processes carried out by the mechanism of finance. But I think that there is in fact a very real distinction between credit and capital. By means of credit, as was shown in the last chapter, borrowers are supplied by the machinery of finance with the right to draw cheques, or to handle other forms of currency. That is to say, by means of credit currency is manufactured for the use of industry and of other users of credit by the financial machine. There is an essential difference between this process and that by which capital is placed at the disposal of industry. We may put it shortly by saying that the machinery of credit manufactures currency or buying power; while capital hands over currency or buying power to industry. The creation of capital thus implies on the part of somebody an act of

abstinence: he refrains from spending money on immediate consumption and hands it over to somebody else to be spent, or spends it himself, on some industrial or national purpose. This is the sense in which capital will be used in the present chapter and throughout this book.

But, as need hardly be said, capital also is one of the terms which economic and financial language has exercised its highest ingenuity in using in different senses. One of the earliest descriptions of capital was given by Turgot, the French practical economist, who defined it as "valeurs accumulées." In this sense of course it applies practically to all forms of what is commonly called wealth: that is to say, all accumulated property which has an exchange value, that is, can be sold at a price. In this sense capital would include houses, clothes, furniture, books: all the instruments and machinery of comfort and enjoyment. In one sense the pearl necklace worn by the millionaire's wife is certainly capital: it is an investment which returns no interest, but it grows in value, sometimes, and it can, if anything goes wrong with the millionaire's enterprises, be turned into goods on which he and she can live.

Nevertheless, in ordinary business language capital is used in a narrower, and it seems to me in a truer, sense in which it has also received theoretical economic endorsement from John Stuart Mill and others. This is in the sense of wealth applied to the production of further wealth: in other words, capi-

tal covers the tools and equipment of industry in the widest sense of the word, including agriculture and transport. This equipment of industry can only be produced, maintained and increased if the community, or a certain number of members of it, refrain from immediate consumption and enjoyment, and place the labour and energy, which they would otherwise have employed for their own gratification, at the disposal of industry for its equipment. If we take a concrete example: a man who spends £1,000 on a banquet to his friends consumes that amount at once in the pleasure of hospitality or the joy of ostentation. If he spends the same amount on gewgaws for his wife, the consumption is not immediate, the jewels are a permanent addition to her armoury of decoration, and can be turned into more practically useful goods at any time, if necessary. But if he puts £1,000 into an investment—a factory or a railway, or a land company—he is increasing the productive power of the world by helping to make and grow the things that mankind wants, or carrying them from the place they are made to the place at which they are wanted. In other words, instead of spending his money he has saved it, and so provided capital for the equivalent of industry; for it is only by saving that capital can be provided.

The responsibility of finance with regard to capital is thus greater and less than in the provision of currency and credit. Finance does not manufacture capital, as it does currency and credit, and con-

sequently its responsibility is to that extent less direct. What it does is to gather the savings of the public and provide the public with investments for the money that it saves. From this point of view its responsibility is immense. As long as it is manufacturing currency and credit it is dealing, as a rule, with business experts who know exactly what they are doing when they ask their bankers for an overdraft or an acceptance, and are just as well aware of all the rules of the game as is the banker or the financier. But the public, on all subjects connected with money matters, is so abysmally ignorant that its monetary knowledge may be said to be a minus quantity. A pamphlet recently received from the United States quotes Mr. Vanderlip of the National City Bank of New York as having described the Americans as a "nation of economic illiterates." If this be true of America it is perhaps even truer of England, and indeed of all countries in which economic civilisation is said to have made any progress. In this direction, in fact, progress cannot be said to have begun, and the ideas of the public concerning the use that it ought to make of its money and the kind of investments that the financial machinery ought to provide it with, with a mouth-filling rate of interest, a certainty of capital appreciating and no risk whatever, are a continual cause of great loss to the public. These ideas also produce a crop of swindlers in the byways of back-street finance, and a consequent oscillation on the part of the public between a blind belief in its

power to make a fortune without any trouble in the purlieus of the Stock Exchange, and an equally stupid conviction that the whole financial centre is tenanted by a gang of swindlers and that every company promoted is as likely as not to be a fraud. As long as these hallucinations are general it cannot be expected that the machinery by which capital is provided for industry by the public can work smoothly or happily. It is said that bitter experience is teaching the public many important lessons, but every year there seems to come forward a fresh crop of people nursing all the familiar fallacies.

From one point of view it is certainly the public's own fault if it is fool enough to expect impossibilities, and consequently, owing to its own greed and gullibility, puts itself at the mercy of financial sharks. The ultimate solution of the problem lies no doubt in better education of the public, which will teach every man that the machinery of finance does not exist to enable him to get rich quick by some lucky stroke of fortune, but to provide him with sound investments into which he can put his money in the expectation of a reasonable return on it. In this matter, as in all others, the production of a better individual is the only way to the improvement of the social average. But at the same time much can be done by finance in purging its byways and back-streets and arranging some system of signposts by which the investor, the real investor, if there is such a person, can find his way to what he wants. Nearly all people who believe

themselves to be investors are, as a matter of fact, gamblers, whose real desire is to make money without any trouble. For people of that kind the only medicine is the loss which their own failure to think clearly probably brings upon them. But the distinction between investment and speculation can be made clearer and should be made clearer, and it ought not to be possible for any investor who really wants an investment, to take the wrong path because he is actually misled and is provided with a speculation against his own desire.

The responsibility of finance with regard to the arrangements by which capital is collected and invested is all the greater in these times, and is likely to become greater still during the difficult period after the war, because capital has for many years been criticised and abused by many well-meaning people who do not quite know what it means: and during the war these attacks upon capital have been growing in intensity and bitterness and are very likely to increase in acerbity and severity. Suspicions concerning capital and capitalists have been nourished during the war, largely owing to the slackness with which the war has been financed by the Governments of the various nations engaged in the struggle. If this war will go down to history as the greatest and most momentous that ever has been fought, it will also be celebrated as the one which, in spite of great accumulation of financial experience of the previous century, has been the worst financed in the history of finance. It

is fashionable to argue that everything bad connected with the war is the fault of Germany, and I think this is really true about the bad finance which has marked its course. Germany began the war with the belief that it was going to be paid for, as far as she was concerned, out of indemnities imposed upon the peoples whom she meant to conquer. Consequently for a long time she raised no fresh taxation whatever, and in fact reduced it, and even when she began to tax she did not attempt to raise enough by taxation to cover even the interest on the war debt, to say nothing of any contribution to the actual cost of war. Consequently the other powers, when they dealt timorously with their citizens in the matter of taxation, were able to point to the example of Germany, to slap themselves on the back, and to thank God that they were not as any German publican. England, which during the first three years of the war did much better than any other power in this respect to meet war's cost out of taxation, had at the end of the period paid less than 20% of the war's cost out of taxation. This compares with 47% in the Napoleonic and Crimean wars. Consequently four-fifths of the cost of the war had to be raised by borrowing or by the manufacture of currency, resulting in the process of inflation. It was argued that this course was perfectly just and fair because posterity will benefit from the establishment of a "world safe for democracy," as President Wilson has well expressed it, and that consequently posterity ought to pay a large part of

the bill. This notion, that posterity can be made to pay, is largely a delusion, since posterity will consume whatever it produces; and by leaving this enormous mass of debt outstanding in consequence of the war, we can merely affect the distribution of the wealth that posterity creates, and not its amount. If a nation borrows abroad, then its posterity will pay the posterity of its foreign creditors; but by no ingenuity can we make posterity pay anything to us.

In the meantime, however, the general public is obsessed by another and very natural delusion, which makes it believe that the rich are growing richer by subscribing to these enormous war loans, and that the great masses of Government securities created are an addition to the wealth of the investing classes. In fact, since it is the investing classes on whom the chief burden of taxation must necessarily fall, because the imposition of heavy taxation on those who are living on the margin of subsistence impairs their efficiency as citizens and so is an economic mistake, it therefore follows that the rich, when they subscribe these enormous sums to pay for the war, are in fact purchasing pledges which bind them to pay themselves interest and to redeem the promises to pay that they will hold. If the warring governments had taken a bolder line, had put the facts of war finance more clearly before the investing public, the investing public would have seen that it would have been cleaner finance, and in their own interests and those of the industry

of the country, to pay a much larger proportion of the war's cost out of taxation, and there would have been much less friction and suspicion on the part of what are called the working classes, who would no longer have believed that the rich were growing still richer out of the war, while they themselves were being exploited by employers, swindled by profiteers, and induced to work longer hours under extremely exacting conditions for higher wages, the benefit of which was taken away from them by higher prices. This mischief has gone so far that these cases of suspicion and unrest were given prominence by reports produced by a Commission enquiring into industrial unrest, appointed towards the end of the third year of the war to discover what was wrong in England with the feelings of the working classes. The subjoined extracts are taken from the Report of the Commissioners for the South-Western Area. One of these Commissioners was Sir Alfred Booth, the Chairman of the Cunard Company, a practical and successful captain of industry, whose opinion cannot be thought to be tainted by any of the dogmas of the economic theorist.

"*Increase in Food Prices*—The one outstanding cause of unrest which we found everywhere is the high cost of living, especially with regard to food. This is accompanied by complaints of exploitation, profiteering, and bad distribution.

"*High Prices of Foodstuffs*—The initial cause of the rise in prices was the financial policy of the

Government, which has relied too much on loans—largely credit loans—and too little on taxation designed to check unnecessary consumption. The result has been a great inflation of credit followed by a very serious inflation of the currency. So long as the present financial policy is continued prices will continue to rise. It is admitted that income tax and super tax could not be substantially raised in general, or even more steeply graded, without a comprehensive reform with regard to the treatment of family incomes. The problem will in any case have to be faced after the conclusion of peace, and it should be tackled now in order to reduce our dependence on further inflation as a means of financing the war.

"*Extravagance, Taxation and Forced Loans*—Our attention was called to the contrast between the man who is compelled to serve as a soldier and the man who voluntarily lends to the Government. It was tersely put to us that the soldier is compelled to serve at one shilling a day, while the man with money voluntarily lends to the Government at 5 per cent. This, it was pointed out, is irritating and unjust. Another cause of irritation is the apparent luxury and ostentatious display of wealth.

"It is evident that after an experience of nearly three years many persons will not curb their extravagance and show of luxury.

"In order to remove the sense of irritation among workers and to assist the national exchequer all unnecessary expenditure of the individual ought to be checked, and this can only be done by taxation or by forced loans."

Such is the state of mind on the subject of capital and the capitalist engendered by bad financing on

the part of the warring governments during the course of the war. What sort of crop the sowing of these economic tares will produce later on time will show. In the meantime it is the business of finance, the prosperity and activity of which is so closely connected with the same views on the subject of capital, to furbish up its armour in this respect and to be ready with an answer when the enemies of capital, greatly reinforced by what has happened during the war, range themselves for frontal attack when it is over. In other words, we have to be ready to show how capital earns its reward.

It has already been shown that capital is wealth set aside for the production of wealth. This is the economic explanation of the matter. Somebody who by working or otherwise has acquired wealth, instead of consuming it on his own enjoyment, puts it into the equipment of industry. But since, from the point of view of the ordinary man, capital is usually regarded as money invested, and since this is what actually happens in practical fact, it is perhaps better to regard capital as so much capital invested, thus carrying the economic analysis a step further. Anybody who earns nowadays is paid in the form of money; he has that money in his pocket or at his bank or in a drawer in his desk. He can use it if he pleases for indulgence in amusement, or he can use it as provision against a rainy day, or for his dependents. If he takes this latter course he is a saver and consequently is likely to be despised

by his fellows, who generally regard the man who saves as a certainly timorous, and probably mean, person, while the open-handed cheerful person who takes all the risks of life with a light heart and spends all that he gets with open-handed generosity is universally regarded as a much pleasanter person to meet and a far more satisfactory member of society. He is said to be giving employment, which he certainly is—it is practically impossible to spend money without doing so. If he spends money on keeping a well-equipped yacht, he employs the services of those who build the yacht, and dig and transport the coal for its propulsion, and the services of the crew and of all who cater for the expensive equipment of this attractive form of pleasure. But all this employment which he gives merely contributes to the immediate enjoyment of himself and his friends, and does not increase the productive power of the world. Spending on pleasure and amusement is surely an excellent thing to do within limits. This is no sermon on the subject of ascetic self-denial which would leave all enjoyment out of the world. All that I am trying to show is that if everybody spent all their money upon enjoyment of this kind there would be no money available for investment, consequently it would be impossible to build a new factory, lay out a new railway, break a new sod in unreclaimed earth. There could be no increase in the demand for labour and the further development of industry would stop. The service of the mean and timorous person who saves

is such that industry could not get on without it.

Capital has been compared to the seed corn used by the farmer. If all the farmers consumed themselves, or sold in order to provide themselves with other objects of consumption, all the corn that they grew, keeping none to be sown for next year's harvest, there would be no corn grown next year. If all those who receive money, that is to say, buying power, spent it all upon luxury and enjoyment, industry would cease just as certainly as corn-growing would cease if all the corn were consumed. So that when reformers of society maintain that capital and the possession of capital are a device for exploiting the worker, taking a share of the product of industry to which they have no claim in justice, the answer is obvious, that if there were no capital there could be no industry, and that the man who saves earns his reward in the shape of interest or profit upon his investments by being the driving wheel which sets all the machinery of industry to work.

Nevertheless, there remains the difficult fact of the hereditary capitalist; the man who has not saved himself, but has inherited from a father or relative or friend a fortune which may enable him to exercise an enormous power over the product of industry without ever having done a stroke of work in his life. The unfairness of this arrangement is at once evident, and there is little need to dwell on the disadvantages that it entails, not only upon all those whose industry is subject to the

charge exercised by such a holder, but also upon the holder himself, who is much too likely to regard the world as a place in which he is only meant to enjoy himself, with the result that he finds it extremely difficult to do so. But when all this is admitted, one has also to acknowledge that there is a great deal of justice, and still more expediency, on the side of the institution of hereditary property. If we go back to the case of the farmer and his seed corn, and if we imagine that all the farmers in a community except one were to consume, directly or indirectly, all the corn that they grew, the one who had kept a store to be sold to produce next year's harvest, would, by every law of justice, be entitled to a reward for his foresight expressed in the price at which he sold or lent some of his seed corn to his less provident brethren. If this farmer were to die, leaving his seed corn to his son, there is much to be said for the contention that it would be very unfair to him that the son should not benefit by his provident action. And it would be the same thing, if instead of leaving it to his son, he left it to a nephew or a friend.

A man's power to pass on the fruits of his labour to those whom he leaves behind, is surely a very reasonable reward. If it is not granted, as things are, one of the strongest inducements to work would be taken away from the greater part of working mankind. Those who own the wealth and capital of the world are in the main representatives of those who by their work and enterprise have made

industrial progress possible in the past. If it had not been for the work and enterprise of those whom they represent, the world would have been a much poorer place, turning out much less stuff for the sustenance and enjoyment of mankind, and consequently with a much smaller population able to enjoy the pleasures of existence.

It is, however, true that Governments have to see to it that those who acquire this power from their own work or from their thrifty and hard-working ancestors should not abuse it. Horrible results have been produced in the past by the abuse of their power by capitalists.

Less than a century ago it was quite usual for children of tender years to be worked in factories and workshops under conditions which now make us shudder to read of them. A number of examples will be found in the chapter on the employment of children in a book called "The Town Labourer" lately published.* We quote from page 175. . . .

"It was reported that there was much more cruelty in the Halifax pits than in those at Leeds and Bradford. A sub-commissioner met a boy crying and bleeding from a wound in the cheek, and his master explained: 'that the child was one of the slow ones, who would only move when he saw blood, and that by throwing a piece of coal at him for that purpose he had accomplished his object, and that he often adopted the like means.' The witnesses examined by a Factory Commissioner at Worsley near

* By J. L. Hammond and Barbara Hammond (Longmans Green & Co.)

Manchester in 1833, said that 'purring,' which was Lancashire for kicking, was a common way of punishing boys and girls in the mines there. The Commissioners of 1842 found that the coal-owners took very little interest in the children employed in their mines after their daily work was over, and it is certainly not difficult to believe this, seeing that when Lord Melbourne was Prime Minister, and delighting England by his graceful friendship with the young queen, the children were working in his mines from 6 o'clock in the morning to 8 o'clock at night. In Lord Balcarres's pits at Aspall Moor the children worked from 5 A. M. to 6 P. M., and some of them were workhouse apprentices. The conditions seemed scandalous enough to the Commission in 1842, but in some respects, at any rate, the children were worse off twenty years earlier. Thus one witness said that when he began to work, at eight years old, as doorkeeper in Felling Pit in 1798, he used to be eighteen or twenty hours down the pit without coming up. Another witness, an underviewer, said that thirty-five years back the boys used to work from 2 A. M. to 8 or 9 P. M. Another witness described the life of a pit-boy fifty years earlier. The boys began at six to eight years old, as trappers, and were paid fivepence a day. From twelve or fourteen to seventeen or eighteen they worked as putters or drivers, being harnessed two together to drag their heavy loads. Their hours were from 2 A. M. to 8 or 9 P. M. every day except Saturday. In busy times they never saw the daylight from Sunday to Saturday afternoon.

"The Commissioners reported in 1842, speaking of the worst practices in the West Riding, that the proprietors disclaimed all responsibility and con-

cern. It is difficult to imagine that the proprietors anywhere else were more sensitive. They included men of great power and influence, men like Lord Londonderry, Lord Durham, Lord Melbourne, Lord Granville. These noblemen did not wash their hands of the business that made their wealth, for they took an active part in putting down strikes and crushing Trade Unions. They differed on many questions, but on those questions they were in agreement. Lord Melbourne made it pretty clear in 1832 that he would have liked to re-enact the old Combination Law, in order to deal with the Miners' Unions. But not one of them seems ever to have opened his mouth on the subject of the slave children in their mines, or supposed that they were under the slightest obligations to the society that gave them their wealth and power."

It seems astonishing now that such things should have happened in a community which believed itself to be highly civilised. The fact that they did happen and that we now regard them as impossible is, from one point of view, a cheering evidence of the improvement in human sentiment on the subject of the treatment of labour that has taken place since then. It should, however, be a perpetual reminder to us not to be too sure that the opinions which we cherish now and the acts which public opinion permits may not seem, less than a century hence, to be just as impossible and incredible to our more enlightened descendants. We have no reason to suppose that the distinguished gentlemen who are mentioned in the extract given above as having

permitted things to be done on their property and for their enrichment which we should now regard as barbarous cruelty, were in fact one whit less humane, sympathetic and large-minded than any of us. They looked at things from a different point of view and would probably have been horrified if it had been suggested to them that they were doing anything inhuman. The reasons for this attitude of theirs and for the change which has since come over men's views about these matters are interesting to consider.

In the first half of the nineteenth century public opinion was strongly under the influence of the view, first put forward by Adam Smith in his great attack upon Government interference with industry, that the obvious and simple system of national liberty is the one thing by which the interests of all parties in an industrial community are secured. It must always be remembered that Adam Smith wrote before the industrial revolution had taken place, and from many passages in his immortal work it is clear that his sympathy with the interests of the labourers was such that he would have been the first to protest against the extreme interpretation that was put by his successors upon his own doctrine. Nevertheless he seems to have held the view that wages were necessarily always on a level which would barely maintain the labourer and his family alive and able to work. This is shown by the well-known passage in which he points out that indirect taxation applied to necessary articles

which the labourers must consume is necessarily paid finally by their employers, because the wages of labour are inevitably such that the labourer could not afford to pay it himself. This pessimistic doctrine had been still further established by the work of Malthus, in which he had demonstrated to his own satisfaction and that of the public which he enormously impressed, that any increase in the wages of labourers merely leads to a more rapid propagation on their part which necessarily reduces their position again to a place on the margin of starvation. Thus misled by their theoretical instructors, it is not surprising to find the most humane and enlightened employers convinced that any attempts that they made to better the lot of those who worked for them were certain to be defeated by economic laws over which they had no control. Subsequent experience has proved that these theories were delusions; that it is possible for the wage earners to attain to a condition of life which is well above subsistence level, and that the Malthusian doctrine is so far incorrect that the greater the control that is acquired over the necessaries and comforts of life, the stronger the tendency becomes not to propagate up to the margin of subsistence, but to reduce the rate of increase in the population.

It was necessary to look back over this dingy period in which economic delusions had such disastrous social effects, because those effects are with us to-day, and are still part of the background of

the working class mind which has to be allowed for by everyone who has any control over, or connection with, the management of capital. The nineteenth century delusions erred on one side in favour of optimism, in the belief that if everybody was left to seek his own interests the best interests of the community would by some pleasant miracle somehow emerge, and on the other hand went to the extreme of pessimism by maintaining the view that no efforts to improve the lot of the working classes could possibly have any practical result.

We now know that this optimistic view could only have been true in a community in which everybody was educated to a very high degree of economic perception and was also gifted with an unusual range of knowledge and discernment concerning the true meaning of their own interests and those of the community. And it has been found necessary that the Government should intervene constantly on the side of those who, being half-educated or not educated at all, and also having no material resources to fall back upon, are necessarily the weaker parties in the industrial bargain. Given this protection by the Government, which is necessitated in the economic interests of the community, the present system of the control of the equipment of industry by means of privately owned capital seems on the whole to be the most workable system, in spite of its obvious drawbacks. The only alternative to it is the control and ownership of the capital by the State or munic-

ipality or some other form of collective ownership. It is commonly supposed that if this system were established, the wages at present paid to capital would be saved by the community. This is a complete misapprehension: capital would still have to be saved and its price would still have to be paid. The difference would be that instead of capital being saved by certain members of the community, it would have to be saved by the community as a whole, which could only do so by either taxing the whole community in order to provide the necessary capital, or, if it abandoned all monetary arrangements, by compelling certain members of the community to do the necessary work in increasing and maintaining the equipment of industry which is now paid for by the private capitalist. Under a collectivist system, just as much as under private controlled property and capital, fresh capital could only be found if a certain amount of work were put, year-in and year-out, into the necessary industrial equipment. And that work, which represents the price of capital, would have to be done, as now, by somebody. Certainly it would be more equitable on paper if this charge for the provision of capital were distributed over the whole community by arrangement made by the Government in the interests of the whole. If we could conceive an ideal Government at work on the job, knowing exactly what its citizens most needed to produce for their material and mental welfare and thus able to induce them to see that work devoted to this object is

the best thing to be done, it is possible to dream of a State in which very rapid progress might be made in the increase of goods required and their distribution and enjoyment.

But anyone who has had anything to do with a Government Department, as they are at present constituted, is likely to agree that, however great their virtues and however acute the abilities that they can command, any community which handed over to them, and to the politicians behind them, who continually obstruct their best work, the entire control of its material welfare, would in a very few years be more than likely to find itself reduced to a state of extreme discomfort, if not on the verge of starvation. Some day perhaps we may develop a Government and people that can rise to the necessary economic pitch for making the arrangement that would be required by the abolition of the private capitalist. Until that day comes, we have to use him and make the best of him, not grudging him the rate of interest and profit he earns, but recognising that without him industry would be impossible, and for this reason encouraging him to produce and multiply as much capital as he possibly can, knowing that thereby we shall get his capital at a cheaper rate than if he and it are scarce, and knowing also that the more capital we can get out of him, the greater will be the demand for labour on the part of those who employ the capital and the cheaper and more plentiful will be the supply of goods of all kinds which they will

pour out for us as consumers. Above all, it seems necessary that those who control the machinery of finance should try to educate the public to a sounder view of the benefit conferred upon the whole community by those who do this dull and unattractive business of saving, and, especially among the working classes, that a saving machinery should be devised in order to encourage the labourers themselves to become as far as possible capitalists.

It has been pointed out before now that if the working classes would for a few years forego the use of alcoholic liquors, they could themselves acquire a store of capital which would go a very long way to ridding them of dependence upon the capital supplied to them by other classes. In a speech at a Labour Congress held last August a very interesting statement was made by Mr. John Hill, its President:

"We have arrived," he said, "at a working agreement which aims at every trade union being a co-operator and every co-operator being a trade unionist, and supporting co-operation industrially and politically: they to be our bankers in time of prosperity and our lenders in time of adversity."

This is a process out of which a highly important movement may arise, and anything that can be done by the machinery of finance to quicken a movement by which the working classes will themselves become capitalists will be of the utmost importance to the economic stability of all countries in which it is developed and the future material progress of mankind.

# CHAPTER V

## COMPANY CAPITAL

CAPITAL, as we have seen, is wealth devoted to production. The capital of companies is wealth put into companies by those who subscribe to their capitals when they are issued. It is thus through companies and their capitals that finance is brought into very direct and intimate relation with the outside public, usually totally ignorant of its machinery. By the institution of companies the public becomes a sleeping partner in industry with limited liability. The public puts money that it has saved into the hands of financial experts who hand it over to industrial experts to be invested in enterprise in the widest sense of the word, to earn a profit for those who have subscribed the money. The system is obviously a development out of private partnerships, in which a certain number of people used to club their capitals together to work some enterprise for their mutual profit.

In the case of a partnership it is usual that the majority of the partners would know something about the business to be conducted, and the risks involved by the enterprise. In the case of joint stock companies, with their capitals owned by an

enormous number of ignorant shareholders, this can no longer be the case, and so the problem that finance has to face is to provide investments for the public which will encourage it to save money for the purposes of industry, and at the same time secure as far as possible that the money so invested shall be well and profitably used. The system is obviously one which carries with it almost infinite possibilities for good or evil, for the increase of the world's wealth or for the waste of its capital on unremunerative enterprise.

The public whims on the subject of the use of its money are extremely difficult to apply to the furtherance of sound production. The normal instinct of the average man is to spend any money that he gets without any consideration for his own future, and still less for the desirability of increasing capital available for production in his own country and in the world at large. Those who do save money are, in many cases, almost irresistibly attracted to the brilliant rather than the sound form of investment. What they really want is a speculation which will give them a large increase in the sum that they have put into the venture. They see attractive prospectuses and circulars promising great wealth beyond the dreams of avarice, and when these ventures do not turn out a success they regard the whole machinery of finance as a complicated swindle, which is best left alone.

It is highly important for the future development of industry that some more reasonable frame of

mind should be developed in the general public on the subject of money and of investment, that it should be taught that the man who spends all that he earns or gets, on his own amusement and enjoyment, leaves the world materially just as poor as he found it, and that if we all managed our money affairs on these simple lines industrial progress would be impossible. It is only those who have saved and so increased the equipment of mankind, in its power over nature to produce, who can feel that they have helped towards that great future when, the material wants of man being easily supplied, he will have some time to look after things that are perhaps more important. Further, it has to be brought home to people who do save money, that short cuts to fortune in most cases lead straight into a morass. That, when they save, what they should try to secure is not a shower of plums from the tree of fortune, but a steady, trustworthy income from their investments, and that it is their business to take an intelligent interest in their investments, following with the help of their expert advisers the fortunes of the companies in which they are interested, and doing their best to select those which are organised and managed on sound lines.

It has to be admitted that there are enormous difficulties in the way of the encouragement of any such reasonable interest on the part of the general public in its investments and monetary affairs generally. The accounts published by most companies

are very far from intelligible to the average citizen. In fact they sometimes seem to be designed to convey as little light as possible, and any ordinary person asked to sit down and scan a company balance sheet might be very well excused if he decided it was quite impossible to make head or tail of it. As an example selected at random the balance sheet of Messrs. Lipton, Ltd., is here appended. (See pages 98-101.)

In one respect its statement is a little bit clearer than many of those which are issued by similar companies. Many of them at the top of the two divisions, into which the balance sheet is divided, put the mysterious statements "Debtor" and "Creditor," and the investor who is trying to puzzle his way round the meaning of the cryptogram, begins to wonder why he should be debited with his capital. Lipton, Ltd., do put as a heading "Capital and Liabilities" on one side and "Assets" on the other. In one sense of course the capital of a company is a liability, since it represents in most cases money received from the shareholders who ordinarily subscribe the capital, and consequently money which the company has to account for to its shareholders (which it does by setting out on the other side assets in which the money has been invested), and to pay back to them, if it can, if the company should go into liquidation and be wound up.

It will be seen from the above balance sheet that Messrs. Lipton have a total capital of £2,350,000, of which £1,000,000 is in the 5% cumulative prefer-

ence shares (these terms will be explained later) and 1,250,000 ordinary of £1 each. This amount is the capital of the company in the strictest sense of the word, representing the money of the proprietors of the concern. Probably it does not all represent money actually handed over at the time of the purchase of the business, because part of the ordinary shares at least may probably have been taken by the sellers of the business when they turned it into a joint stock company and invited the public to take shares in it. But as it stands this represents the interest of the proprietors, who share in varying degrees in the profits earned by it, and in the distribution of the assets in the event of winding up.

There is also a liability in the shape of debenture stock, bearing 4% interest. Debenture stocks, or mortgage bonds as is the more usual form in America, are sometimes spoken of as the capital of the company, but they are in fact not capital but debts. The interest upon them has to be paid before the owners of the capital receive anything by way of dividend, and in the case of winding up they rank first.

It is very important that the public, in making investments, should bear in mind this difference between becoming creditors of a company by buying its debenture stocks or mortgage bonds, and taking the more speculative risk of becoming a partner in the enterprise by holding preference or ordinary shares. The other large items on the liability side

# LIPTON LIMITED

## BALANCE SHEET AS AT 14TH MARCH, 1914

### CAPITAL AND LIABILITIES

| | | | |
|---|---|---|---|
| **CAPITAL:** | | | |
| Cumulative 5 per cent. Preference Shares of £1.. | | £1,000,000. 0. 0. | |
| Ordinary Shares of £1..... | | 1,250,000. 0. 0. | |
| | | | £2,250,000. 0. 0. |
| Debenture Stock, 4 per cent.................. | | | 500,000. 0. 0. |
| Bills Payable.............................. | | | 297,636.13. 9. |
| Overdraft from Bank......................... | | | 159,727. 2. 1. |
| Sundry Creditors and Directors' Fees......... | | | 207,295.12. 3. |
| Savings Bank Deposits and Interest accrued thereon .................................. | | | 161,951. 0. 6. |
| Unclaimed Dividends......................... | | | 3,026. 4. 2. |
| Interest on Debenture Stock accrued at Date. | | | 8,974. 5.11. |
| Premium on Shares Account.... | | £220,888.17. 3. | |
| Reserve Account................ | | 145,000. 0. 0. | |
| | | | 365,888.17. 3. |
| **PROFIT AND LOSS ACCOUNT:** | | | |
| Balance brought from previous year .......... | £31,702. 8. 6. | | |
| Profit for year ending 14th March, 1914.... | 160,286. 5. 5. | | |
| | | £191,988.13.11. | |
| *Deduct:* | | | |
| (a) Interest on Debenture Stock for year........ | £20,000. 0. 0. | | |
| (b) Interim Dividend on Preference Shares paid 30th September, 1913... | 25,000. 0. 0. | | |
| (c) Interim Dividend on Ordinary Shares paid 19th November, 1913 .......... | 37,500. 0. 0. | | |
| | | 82,500. 0. 0. | |
| | | | 109,488.13.11. |
| | | | £4,063.988. 9.10. |

# LIPTON LIMITED

## BALANCE SHEET AS AT 14TH MARCH, 1914

### ASSETS

| | | | |
|---|---|---|---|
| Goodwill of the Business, Freehold and Leasehold Properties, and Freehold Estates in Ceylon. | | | |
| Amount per Balance Sheet at 15th March, 1913, at Cost, less amounts written off for Depreciation... | £1,847,824.11.1. | | |
| Additional Capital Expenditure during year... | 10,115. 6.7. | | |
| | | £1,857.939.17. 8. | |
| *Less* written off for Depreciation and Lease Redemption during year................ | | 4,978.18. 4. | |
| | | | £1,852,960.19. 4. |
| Plant, Machinery, Fixtures, Fittings, Utensils, Carts, Horses, &c. | | | |
| Amount per Balance Sheet at 15th March, 1913. | £558,501. 7.8. | | |
| Additions during year at Branches | 8,403. 3.9. | | |
| Additions during year at Stores, Factories, &c... | 13,813.14.3. | | |
| | | £580,718. 5. 8. | |
| *Less* written off for Depreciation during year............ | | 18,222.13. 3. | |
| | | | 562,495.12. 5. |
| Stocks-in-Trade, per certified Inventories..... | | | 1,084,337.16. 4. |
| Sundry Debtors.............................. | | | 329,630. 1. 4. |
| Insurances unexpired and other items paid in advance .................................. | | | 19,569.11. 8. |
| Investments at Cost and interest, &c., accrued thereon (Market value, £91,713.3s.10d.)...... | | | 99,892.15. 1. |
| Savings Bank Investments at Cost, and Interest accrued thereon (Market value, £30,661.0s.0d.) ................................ | | | 32,772. 7. 0. |
| Cash at Bank and on hand.................... | | | 82,329. 6. 8. |
| | | | £4,063,988. 9.10. |

## PROFIT AND LOSS ACCOUNT FOR

**Dr.**

| | | |
|---|---|---|
| To Expenses of Management, including Salaries, General Charges, Head Office Expenses, Auditors' Fees, Transfer Office Expenses, Savings Bank Expenses, Advertising and Law Costs | | £121,489.13. 9. |
| " Bad Debts | | 3,746.19.10. |
| " Interest on Savings Bank Deposits | £5,612. 7.5. | |
| *Less* Interest on Savings Bank Investments | 1,217.15.7. | |
| | | 4,394.11.10. |
| " Depreciation on Plant, Fittings, Fixtures, Utensils, &c., at Stores, Head Office, and Branches and in Ceylon; also Provision for Depreciation of Leaseholds | | 23,201.11. 7. |
| " Directors' Fees | | 1,200. 0. 0. |
| " Fees to Trustees for Debenture Holders | | 630. 0. 0. |
| " Balance carried to Balance Sheet, being Profit for year | | 160,286. 5. 5. |
| | | £314,949. 2. 5. |

## YEAR ENDING 14TH MARCH, 1914

| | Cr. |
|---|---|
| By Profit on Trading at Stores and Branches (after deducting Wages and Working Expenses) and Profits from Estates in Ceylon | £310,534.10. 8. |
| " Transfer Fees | 403.19. 0. |
| " Interest, &c., on Investments | 4,010.12. 9. |
| | £314,949. 2. 5. |

### Auditors' Report

We report that we have obtained all the information and explanations we have required as Auditors.

We have examined and compared the foregoing Balance Sheet and Profit and Loss Account with the Books and Vouchers kept in London and the returns received from Ceylon, Calcutta, Bombay and Sydney, and find they are prepared in accordance therewith; and, subject to the question of depreciation which is dealt with in the Directors' Report, in our opinion the Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs according to the best of our information and the explanations given to us, and as shown by the Books of the Company.

LONDON, 25th June, 1914.

of the balance sheet are bills payable for nearly £300,000 and an over-draft from the bank for £160,000, sundry creditors for £207,000, and savings bank deposits and interests accrued thereon for £162,000. These items may be put together as representing what is called floating debt, and they represent a total of £820,000, against which on the other side of the account we see sundry debtors £330,000, and investments and items paid in advance, £120,000. There are also total reserves among the liabilities amounting to £368,000, of which £145,000 has apparently been reserved out of the profits, and £221,000 has been provided by the issue of shares from time to time at a premium, that is to say, by their sale to the public at a higher price than the £1 each for which they stand as a liability. These total reserves of £366,000 are thus in a sense the property of the shareholders just as much as the capital that they have subscribed. They have been produced either by profits earned in the course of the business or by sales of shares, owing to the company's good credit, at a premium. This reserve account should thus be added to the capital of the company in considering what its position really is if it went into liquidation. It is not money that has definitely to be paid to creditors but it is, like the capital, money which has to be accounted for to shareholders and made good to them if the assets on the other side of the balance sheet can be sold to produce the prices put against them.

The other items on the liabilities side represent the sums which have to be accounted for from profit and loss account, that is to say, the net earnings of the company represented by the amount brought forward from the previous year, the amount of profit for the year under review, less sums paid out for interest on debenture stock and interim dividends on preference shares and ordinary shares. We thus find out of the total of over £4,000,000, to which both sides of the balance sheet add up, about £2,700,000 are represented by claims on the part of shareholders, and a balance in the shape of debenture stock, bills payable, over-draft, creditors, savings bank deposits, etc., definite claims which creditors would enforce in case of liquidation before the shareholders received anything. It should be added that the item of savings bank deposits and interest accrued thereon is unusual in a commercial balance sheet of this kind. Messrs. Lipton have seen fit to add to the facilities given to their customers the provision of a savings bank as well as tea and groceries. It is perhaps a somewhat questionable policy for a commercial company of this kind to embark in unless the savings bank business is kept absolutely separate from the other activities of the enterprise and the money received from savings bank depositors is represented by investments specially made on their behalf. In fact we see among the assets an item of £30,000 odd of savings bank investments. These investments are presumably of the kind which could be easily sold, so that

any sudden rush of withdrawals could be met out of them.

There are thus two rather distinct forms of liabilities of a commercial company or of any other company. There is the definite sum due to creditors or on bills payable, or on over-draft from bank which have to be met unless the Company admits itself insolvent; and there is the rather more hazy item of Shareholders' Money in the form of capital and reserve funds accumulated, which the Company has to make good if it can.

Now, when we look at the other side of the balance sheet, we come to a really interesting question because the value of most of the assets in most companies is, to a certain extent, elusive. The first asset we find is the Goodwill of the business, Freehold and Leasehold Properties and Leasehold Estates. The value set against this item is arrived at by taking the amount in the previous balance sheet which, we are told, was the amount at Cost, less amounts written off for Depreciation. There is then added an additional capital expenditure during the year, and the amount written off for Depreciation and Lease Redemption during the year, is deducted and so we arrive at the big total of £1,853,000; and the question which every shareholder would like to know if he tries to study the balance sheet with anything like intelligent interest is, whether these assets in which his money has been invested would, if they had to be realised, produce more or less than the sum at which they stand in the balance sheet.

This is the point on which nobody can be sure because nobody knows the value of any asset, with the exception of Cash in Hand and a few really marketable securities which can be depended upon to produce the price if sold, until the value of the asset is tested by an attempt to sell it. The value of the thing being what it will fetch, one can never be quite sure of its value until one actually tries to see what somebody will give for it.

The goodwill of the business is a thing which always puzzles those who are not used to this mysterious term. It means practically the value of the connection and the selling power of the business when it was bought, and it is an item so difficult to calculate that very widely differing rules have been suggested for arriving at it. One of these rules, for instance, says that three years' purchase of the profits of the business is enough to give for goodwill of any commercial concern under the sun. This is too hard a saying in some cases, but one thing is certain, that goodwill is not an item that one likes to see flourishing at large in any balance sheet. The best financed companies, such as Banks and Insurance Companies, write the goodwill off out of the profits as fast as they can, whenever they acquire an existing business, and pay for it anything over the actual old iron value of the assets. It is still more objectionable to see the goodwill of the business, as in this case, not separately valued in the balance sheet but mixed up with Freehold and Leasehold Properties so that the shareholder,

in trying to arrive at a solution of the problem of the real value of the assets, does not even know how they are classified, how much, for example, of this £1,853,000 represented by the first item among the assets is good will and how much is freehold and leasehold properties and estates.

This question is a very important one, because, if anything went wrong with the Company and it found itself obliged to turn its assets into cash, its goodwill would, from the nature of the case, be reduced in value by the fact that it had fallen on evil days; whereas freehold properties and estates might easily escape the contagion of the Company's misfortunes if they were well placed. All that you can be sure about this first asset is that it represents what certain properties and the connection and selling power of Messrs. Lipton were sold at to the public when the Company was formed plus subsequent additional capital expenditure, less the amounts written off since the Company has been in existence for depreciation. Whether these amounts, so invested, were well invested at the beginning, whether the assets purchased have increased or decreased in value since they were bought, whether sufficient allowance has been made for depreciation of these assets which, such as leasehold properties, are necessarily declining in value—all these are things as to which the average shareholder can supply no light whatever.

It is the same thing with the next item among the assets, Plant, Machinery, Fixtures, Fittings,

Utensils, Carts, Horses, etc. It is the same thing, only much more so, because all these items are things which are obviously wearing out with more or less rapidity, and any attempt on the part of a shareholder to guess whether the price ordinarily given for them was right, whether a sufficient amount has been written off for depreciation since they were bought, and how they would fare if they had to be sold in course of liquidation, would only land him in a maze of bewilderment. They will know, when they read the Auditors' Report, that, subject to the question of depreciation which is dealt with in the Directors' Report, the Auditors consider that the balance sheet is properly drawn up, etc., according to their formula; and they will see, if they look at the Directors' Report, that, having spent during the year £23,979 on Repairs and Renewals, the Directors are of opinion that the amount of £23,202 which they have allowed for depreciation is sufficient. The shareholder's confidence in the Directors of a Company will doubtless assure him that the Directors would not form this opinion without good reason; but, considering what human fallibility inevitably is, there is still a certain mistiness about the value of over half a million assigned to this item in the balance sheet.

Then we come to Stocks-in-Trade, per certified Inventories, of over one million. This is the stock of goods which Messrs. Lipton hope to be able to sell to their customers at a profit and, under ordinary circumstances, would no doubt succeed in do-

ing so. But here, again, there is always the possibility of a fall in prices which might upset the value put upon this item in the balance sheet; and then we come to sundry debtors £330,000, as to whom the shareholders can only hope that these debtors are good and will duly pay what they owe to the Company.

With regard to the other items there is less element of uncertainty. Insurance expenses and other items paid in advance are a definite fact about which there can be no doubt. Investments at cost and interest accrued thereon stand in the balance sheet just under £100,000, and a note in brackets tells us that the market value of them is less than £92,000. The savings bank investments at cost and the interest accrued thereon standing at nearly £33,000 are again stated in a note in brackets to have a market value of under £31,000. So that with regard to these two items, to which the more or less trustworthy test of market value can be applied, we find that their market value is considerably below the value given in the balance sheet.

Finally we come to cash at bank and on hand, concerning which there is no doubt. There it is, £82,000 odd. These doubts which any shareholder scanning any balance sheet is justified in feeling about what might happen if the assets, which he sees priced at such and such a figure, had to be sold in order to return his capital, apply with more or less strength in the case of nearly all balance sheets which anybody can contemplate. The near-

est approach to certainty can be got in the case of investment companies whose assets consist entirely of marketable securities with a free market and a trustworthy quotation. Any balance sheet which contains freehold property, buildings, plant, machinery, utensils, equipment, horses, carts, and a big block of stock-in-trade, whatever it may be, may always involve a certain amount of guess work. All that the public can do is to try to repose confidence in the right people, and to believe that the Directors of the companies with whom it places its money make the most earnest endeavours always to keep the balance sheet with the closest possible relation to veracity; but then the public's power to distinguish between the amount of confidence to be reposed between one Board of Directors and another is almost nil. The best kind of Directors are the men who are, or have been, hard at work in some-sort of business similar to the kind which is done by the Company, and are the least known to the general public. We still seem to be a long way off the very necessary amount of knowledge which ought to be secured to every shareholder before indulging in an investment, and until this knowledge can somehow be granted it is hardly reasonable to expect that industrial investments will be really popular.

It is not wonderful that the average shareholder when faced by a Company balance sheet should give up the task in despair of trying to unravel its mysteries and should usually test the value of a security

by some quite irrelevant consideration, such as the fact that it owns a shop at the corner of his street, or by its paying a good dividend or because he has heard from a friend who has a relative in its employment that it is a very good thing to have money in. Sometimes he is guided in his choice of investments by the names of the Directors, but in England this method of guessing the value of the security is somewhat out of fashion. British snobbery used, at one time, to have a preference for Companies whose Boards were decorated with the names of peers, and some years ago a case was fought in the English courts in which a gentleman brought a claim against a Company promoter for 500 guineas which was the fee alleged to have been promised to him for securing a certain earl to sit on the Board. His claim was found to be a good one and he got his money, the judge remarking that it was a queer kind of traffic, but the arrangement appeared to be entirely businesslike—the claimant had carried out his promise and was entitled to his money. Experience, however, has taught the British public that it is not always a trustworthy method of assessing the prospects of a Company and, as a balance sheet is usually beyond their comprehension, their methods in investment are usually reduced to haphazard guess work, except in those fortunate cases when they get hold of a first rate stockbroker and trust him and follow his advice. In the present state of the economic education of the public perhaps this is the best system that can be

devised, but it is urgently desirable that those responsible for the machinery of finance should do their utmost to encourage a healthy intelligence among all classes of people as to the duties of the investor and the common sense with which he should fulfil them. It pays finance that there should be as little bad and rotten finance in existence as possible. To secure this end it is necessary, in the first place, to try to teach the public what investment means. Mr. Vanderlip, as already quoted, has lately said that the Americans are a nation of economic illiterates; the pamphlet, in which I saw this remark of Mr. Vanderlip's, wanted to know what Mr. Vanderlip and other American bankers had been doing to correct this state of things. Whether it is fair to impose this duty of teaching the public upon financiers is an open question, but there can be no doubt that it would pay them very handsomely to do so. Any measure that would increase the knowledge that the public has concerning the benefits conferred upon the community and upon mankind at large by those who save money and invest it well, would be an enormous gain to those who handle the machinery of finance and wish to see finance purged of the evil, crawling things that creep about the dark places in its hinterland, but this is a long process and would take many years to compass. In the meantime something at least can be done to secure greater clearness in balance sheets and a higher ideal of good finance among those responsible for the investment of the

public's money. A balance sheet taken by itself throws very dim light on the position of the Company that publishes it. It is a fairly common practice in America to give on every balance sheet the corresponding figures of the previous one, and there seems to be no reason why this system should not be made universal. It should also be recognised that a balance sheet is not really designed to conceal the position of the Company, but to make it as clear as possible and for this end the fullest detail is desirable and the system by which, as is shown in the example given above, an item like good will is lumped together with freehold and leasehold properties, should be discouraged. Unfortunately in the course of the war there has been some retrogression among English Companies. It is cynically suggested that this process has been encouraged by the imposition of the Excess Profits Tax which has made companies eager to give as little as possible information concerning their position. There is probably very little truth in this suggestion, because the Inland Revenue authorities are hardly likely to be guided much by the inspection of the published balance sheet in the case of any companies concerning whose earning power they have reason to wish for fuller information, but it is not a good sign to see two at least of the great English Steamship companies making their balance sheet into a farce by having one item only on its asset side in which their whole property is lumped together in one preposterous jumble.

But when all this is said the fact remains that

for years to come the general public will be worse than ignorant on the subject of investment and, since it is above all necessary for the material progress of mankind that the investor should be protected against his own folly and stupidity and should be encouraged to save money and invest it by the knowledge that he can do so with the greatest possible confidence, financiers should try to devise some means to this end. Hitherto the highest class of financiers have, at any rate in England, confined their operations chiefly to Public Securities, such as Government and Municipal Loans, and to issues made by great railways and occasionally, and rather as a concession, to the securities of very first-rate industrial companies. Consequently it has been left to a horde of second and third-rate company promoters to deal with the very important question of the promotion of the ordinary industrial company, in the preparation of its prospectus and the market in its securities. And Mining shares, in which gambling possibilities and the uncertainties of what may happen underground have added to the inevitably doubtful elements that are associated with so many investments, have been left very largely in the hands of people who have frankly invited the public to a gaming table in which the odds are largely in favor of the bank. It is a question whether the really high-class financial leaders have not made a mistake in adopting this rather exclusive attitude. Any losses that are made owing to dishonest company promoting and mining swindles are debited by an unreasonable

public to the financial centre as a whole, though it is probably a place in which there is a generally higher level of honesty than in most other circles of the community. As compared to the haunts of politicians and lawyers it shines like a good deed through a naughty world. It is difficult to see how the purging process can be brought about, but there is no more urgent need. It might perhaps be done by some extension of the system adopted in England of what is called Trust Companies. These companies make it a business to invest the capital that they receive from their shareholders in the securities of other companies, thus enabling each of their shareholders to spread his risk by each holding part of the capital of the Company, which, in its turn, holds a large and diversified amount of securities. The system has not been without its critics. One cynic remarked concerning it that a Trust Company was a concern which enabled people to hold collectively a mass of securities not one of which they would touch individually. Nevertheless it has been on the whole fairly successful; and it might be possible for the leaders of finance, by undertaking through this means, modified for the purpose, the business of investing the money of the public for it, to devise a machinery by which investors should be certain that by acquiring securities in Trust Companies with certain names on the Board they would be putting their money collectively into securities which had at any rate been selected by experts after due consideration of their merits.

# CHAPTER VI

## THE MANUFACTURE AND MARKETING OF SECURITIES

COMPANIES and the securities which represent claims on their property and profits come into being by the issue of a prospectus. As everybody knows, Joint Stock Companies are formed either because somebody has a notion for an enterprise and not enough capital of his own to work it and consequently appeals to the general public to put funds into it on the expectation of profits to be earned, or because the owners of an existing business wish, for various reasons, to turn it wholly or partly into cash by inviting the public to subscribe for its capital. Or sometimes again because owners of an existing enterprise wish to increase the amount of capital at their command and think that they can do so most cheaply and simply by turning it into a Joint Stock concern and so getting money from the public with which to increase its scope. Whichever of these causes be the origin of the Company, an appeal to the public through a prospectus is the usual course for supplying the capital.

On this subject of prospectuses, and the regulations and restrictions under which they should be drawn up, there has been in the past much contro-

versy, and there is likely to be more in the future, when, after the war, appeals for industrial capital once more become possible. On this question, as on so many others, there are two main schools of thought, one of which advises as much freedom as possible for those who invite subscriptions from the public for new securities and in the terms in which they appeal to it, and the other is in favour of strict regulation and control, either by the Government or by the authorities of the Stock Exchange, with a view to protecting the public against its own ignorance. The question is an extremely difficult one on the face of it. In individualistic nations like America and England the attractions of freedom seem to weigh down the balance. The old legal doctrine *Caveat emptor,* signifying that anybody who makes a bad purchase has only got his own stupidity to thank, is a nice simple rule which saves everybody a great deal of trouble and throws upon the individual the responsibility for looking after his money. It would be an ideal principle to work upon if everybody were even reasonably educated on the subject of money matters. As it is, the full and logical application of this principle leaves so many doors open to fraud and swindling, for which the ignorance and stupidity of the public are ultimately responsible, that good finance is besmirched by the wrong-doing of its unsavoury hangers-on.

It is very like the old theory that there should be absolute freedom of contract between man and man

and that anything like Government interference in such matters as wages or factory conditions was an unwarrantable hampering of individual freedom which could only do harm in the long run. Here again the principle would have been absolutely sound if the people to whom it was applied had been treated on this ideal basis, but, when it was a question of complete freedom of contract between, on the one side, a set of employers who had wealth and knowledge behind them and could afford to wait and keep their works shut up if they thought it suited their interests to do so, and, on the other, a set of workmen with no resources to fall back upon, no education that could tell them what other chances there were of employment in other lines of life and nothing but starvation ahead of them if they were, for any length of time, out of work, the application was so obviously unfair that the Government has had to interfere more and more with the working out of the principle of freedom.

In money matters it is very much the same thing. We have, on the one side, a public which understands little or nothing about the machinery of investment and is impelled by many of the most obvious qualities of the human mind, such as its improvidence, its desires to back its luck and its eagerness to acquire wealth without trouble, to make bad mistakes whenever it approaches practical questions of finance. It is easy to answer that the public has only to choose a good stockbroker or a good financial adviser, put confidence in him

and follow him and all will be well with it. This is perfectly true, but how is the public to know who is a good stockbroker or who is a good financial adviser? There seems to be no way round the difficulty except the terribly slow one of the gradual education of the public to a state of more common sense about money matters and more intelligent interest in what happens to its money, so that it may give at least as much attention to investing its savings as it does to buying its clothes or its cigars, and, at the same time, the working of the process by which somehow or other the best elements of finance shall be able to exercise a greater control over the worst ones, whose misdoings, at present, are continually bringing the whole machinery into disrepute. In the meantime can anything be done by stricter Government regulation in regard to the preparation of prospectuses and the formation of companies?

In Germany, the land where freedom gets short shrift, and finance, like most other departments of life, is controlled and ordered about by a Sergeant-Major of a Government, it cannot be claimed that the regulations and control imposed have eliminated the swindler from German life. Experience in England of Government control during the war in matters of new issues and of finance in general, is not likely to cause any general hankering for its continuance a moment longer than is warranted by the war's interests. Delays and redtape have, as seems to be inevitable with Government regulations,

strewn the path of Treasury control over new issues of securities with blasphemous criticism.

Finance, however, can, I think, do something on its own account to try to improve the standard of prospectuses and the methods of company promotion, pending the long delayed date when the public may perhaps have learnt some sense for itself. It is not well that small companies with speculative possibilities and small capitals, which lend themselves so easily to Stock Exchange manipulation, should be left in the hands of third rate company promoters. The great ones of the earth in finance must see that the system by which they restricted their operations to Government and Municipal loans, railway issues and a few very select industrials, has not been good for them or for the public. These are democratic days and it is above all desirable that capital should be made as democratic as possible. What we want to secure is to see that every member of the community, who has any control over money, shall see that saving it is not an act of skinflint meanness, but one that confers benefit on the community and furthers the economic progress of mankind, and that his savings, however small, shall be well taken care of on his account and that he shall not be induced by misrepresentations and deceptions to throw his money down the sink and consequently to be convinced that it would have paid him much better to have spent it on his own amusement.

Every good industrial prospectus that appears

makes all the bad ones look worse. What we want is that there shall be as many good ones as possible so that the bad points of the bad ones may be made more glaringly apparent. The good points of a prospectus, as of a balance sheet or any other financial statement, consist, as one need hardly say, of clearness, candour and fullness. Anyone who picks one up ought to be able to see from its perusal exactly what the company is buying, exactly what it is paying for it, exactly what has been paid for it by any vendors who have passed it on from one to the other, say, during the previous two years, exactly what its previous earnings have been year by year and not over an average, and exactly what arrangements have been made with regard to the placing of the capital by underwriting or otherwise, that is to say, how much is being paid to anybody who may be undertaking to take over the securities issued if the public fails to do so. It is a fairly modest claim to urge, that the public should be told this much before it is asked to put money into a company that is appealing for subscriptions, but a very large number of prospectuses that used to appear in the past would not have come up to this comparatively modest ideal.

When we come to the forms of securities they may, as a general rule, be roughly divided into three. There are, first of all, the securities which embody not proprietorship or partnership in any company or concern, but creditorship, involving, sometimes more and sometimes less, the right to wind the com-

pany up and to foreclose on its property in case the interest due is not paid to date. In this category would also be included the debts, bonds or obligations, whatever they are called, of Governments, Municipalities and public bodies, the great advantage of which lies in the fact that their security does not depend on the earning power of any particular enterprise or company, but on the taxable capacity either of the nation or the State or of a town or of a country district which has been made responsible for the due payment of the interest and repayment of the debt by its legally empowered authorities.

It is in this class of securities that the real investor finds what he wants, if indeed he can be really said to exist. The real investor, though the line between investment and speculation is a very difficult one to draw, is, in my opinion, one who puts money into securities, not with any view to an increase either in the income from them or in the capital value of them, but simply in the hope of a secure and exact interest upon them, with the certainty of repayment some day at due date if the security be made so definitely repayable. A real investor, as long as his interest was secure, would never bother to look in the papers to see whether his securities had gone up or down a quarter, and it would not occur to him to jump in and out of them on the chance of increasing by a few pounds the capital that he invested.

As a matter of fact very few of us find ourselves able to cultivate this philosophical detachment on

the subject of investments. Most of us feel pleased if our securities go up in price and are tempted to sell them and to put the money into something cheaper and repeat the operation. We ought, of course, to know that if our securities have gone up, and if their security has been at all times unimpeachable, they have not gone up for any reason affecting it, but merely because the demand for first rate investments has been greater than the supply and that consequently all equally good securities will have, roughly and more or less, risen together. It will, therefore, not be possible to take advantage of the rise by acquiring any other security that has lagged behind, and that what we shall really be doing if we effect an exchange, will be to buy something that is not quite so well secured and cross the boundary line into speculation by buying in the hope of a rise.

Other forms of securities are those which, more or less, imply proprietorship of a company instead of the more privileged position of a creditor. If you buy preferred or preference, or common or ordinary stocks and shares you become a proprietor. If you hold preference of preferred securities you will find yourself entitled to a fixed rate of dividend which may, or may not, be cumulative, that is to say that if, in one year, the company is unable to meet it, the arrears will have to be met before the ordinary stockholders receive any dividend. It is also usual for the preference holders to be given priority in the event of liquidation. That is to say, if the

company is wound up and its assets, after meeting all due debts, do not leave enough to pay off in full the preference and the ordinary holders, the preference holders have a right to the return of their capital before the ordinary get anything.

Since preference holders then have priority in income and in return of capital, it is usual for their income and for their claim for return of capital to be limited to a fixed rate in one case and to the face value of the security in the other. Sometimes, however, they receive the right to participate both in income and assets after the ordinary have received a fixed amount, but, in any case, the preference holder is on a different footing from the creditor, because he, by becoming a proprietor, has thrown in his lot with the company and shares in its fortunes with specified limits.

Many people, consequently, have a holy horror for preference and preferred securities, arguing that if the company does well they get no more than their fixed rate of dividend, whereas if the company does ill their preference right is almost certain to be evaded by the threat of compulsory liquidation with possibly disastrous results, that debts ranking ahead of them can, at any time, be created and that consequently they are neither an investment nor a speculation, but a miserable compromise with the advantages of neither. It cannot be denied that there is some truth in these contentions. It seems to be more reasonable to make up one's mind exactly whether one does want an investment or a specula-

tion—if only one could be really honest with oneself on the point—and, having made up one's mind, to go for one or the other instead of compromising on an amphibious hybrid.

In Ordinary stocks and shares the speculative element is inevitable, that is to say, if the security is really Ordinary, and it is entitled to take all the profits left over and above for division, after meeting interest on debt and dividends on Preference shares, and, in the case of liquidation, to take whatever is left of the capital assets after debts and Preference holders have been satisfied. But it sometimes happens that a share which is called Ordinary is entitled to a cumulative rate of interest, and one finds that there is a Deferred share or a Management share or a Founder's share or some other kind of security which takes the final bite off the profits of the concern.

Sometimes, often in fact, these Founders' or Management shares only rank for dividends after the Ordinary has received a certain amount and they divide the balance of profit, either taking one half of it or some other agreed portion. The existence of this kind of security is often criticised as bad finance and as likely to lead to Directors and Managers, in whose hands these securities generally stand, dividing too much of the profits of the business so that the income from their Founders' or Management shares may be satisfactorily increased. It seems to me that there is not very much in this criticism, though there may have been cases in

which rascally Boards may, by paying too high dividends, have put too high a value on their Founders' shares, and then passed them on to some ignorant person who did not understand the game. But this kind of rascality, when it is on the war-path, can find plenty of opportunities quite apart from the existence of Founders' shares, and there have, in fact, been many excellently managed and financed companies in which Founders' shares have been prominent in the picture.

With regard to this question of the denomination of shares and securities, the only suggestion that need be made is that companies might be obliged, either by law or by the regulations of the Stock Exchange, not to apply labels to securities that are in any way misleading, as, for instance, when a security is called a prior lien or a first mortgage, when its actual qualities do not entitle it to any such respectful designation.

When we come to the question of the market in securities and the rules and regulations, if any, which might secure the elimination of securities in which it is not good for the public to deal, we are faced again with the same problem as in the case of regulation and control of prospectuses and company promotion. If control is secured, there is an end of that freedom and elasticity which is the basis of the best qualities of the Anglo Saxon race and has been the foundation of the enormous wealth and prosperity that it has built up on both sides of the Atlantic and all over the world.

If we do not control at all, we leave the greed and ignorance of the public face to face with a horde of sharks who are only anxious to prey on it and do so with chronic and continuous success. This is the rough cure by which the economic Providence tries to teach mankind not to be a fool about its money. But when we leave the disease to be handled by this drastic but very slow working treatment, we allow things to happen which cause misgiving and misapprehension in the eyes of a critical public—when it is seen that shady company promoters and people who make a living by preying on the gullibility of the public found County families and hand on to their offspring a substantial claim for all time on the productive power of humanity. People naturally begin to wonder whether a financial system which permits these things, is really admirable, and whether it would not be better to hand over the whole business of wealth producing and consumption to the State.

To anyone who believes in individual freedom and individual initiative as the real basis of energy, progress and morality and everything else that counts, the growth of such a view seems to be disaster, but, just as democracy is on its trial in the war, individualism, and with it the institution of private property, will perhaps be still more severely on their trial when the war is over and our financial system, which is so closely allied with both, will have to do its very best to purge away any blemishes which could be used as a brick-bat by the critical.

In most Continental countries the closest watch is kept by Government over the admission of securities to quotation on the Bourse. As is well known, this weapon has, in the past, been effectively used by Governments in order to obtain diplomatic and fiscal concessions. In France, for example, if there were any question of a quotation being granted to a loan, say of a South American Republic, the authorities, before giving the requisite permission would be likely, in the first place, to stipulate that at least a proportion of the money raised by the loan should be spent in France, and would very likely take the opportunity to make representations concerning any tariff imposed upon French wines or other goods.

In England before the war the Government had no control whatever upon the action of the Stock Exchange Committee in granting or withholding quotations to securities. It was often urged that either the Government or the Committee should make the same stipulations as Continental Governments when foreigners came to us asking for a market for their securities; and that it should be a condition that any money subscribed to loans in England should be spent, at least in part, in this country, so giving employment to British industry. In fact the absence of any such restriction often brought financial business to London which it would otherwise have missed, and it came to us because the borrowers did not care to submit to the stipulations imposed in Paris or elsewhere. Moreover, it seems

to me, that the effectiveness of these stipulations is a delusion. They are not really necessary at all. Any country that borrows from another must necessarily stimulate the export trade, in the widest sense of the word, of the lender unless it makes use of the loan merely to repay previous indebtedness or to meet interest which it would otherwise be unable to provide, or takes away the proceeds in gold. We know, as a matter of fact, that this latter means of payment of the money that was lent by English financiers was hardly ever employed; consequently, although it did not follow that the borrowing country actually spent the money that it borrowed in England, its action in borrowing here meant that English industry had to make an export of some kind, somewhither, because the loan that had been made by the financiers gave somebody a claim over English goods and services which could only be met by their export.

If it is desirable that stricter regulations should be made concerning the kind of security that is allowed to be quoted on the Stock Exchange, it certainly seems to be desirable that the responsibility in this matter should be in the hands, not of the Government or of any official authority, but in those of the Stock Exchange, working in the interests of finance and all its customers.

When once official interference is introduced, in the first place you get red tape and all kinds of official delays, absurd restrictions and a multitude of incomprehensible forms to be filled up. These

are mere puddles in the road of progress which can be stepped over by those who are used to them, but a much more serious objection lies in the fact that when once the Government exercises the power of refusing the right to issue securities or to quote them and deal with them on the Stock Exchange, the public inevitably jumps to the conclusion, in spite of the most explicit and carefully worded disclaimers to the contrary on the part of the Government, that any issue which is authorised to be brought out, quoted and dealt in, has been hallmarked by the Government.

I came across a very pleasant practical example of this curious tendency, in the course of 1916, when an extremely unfortunate company was authorised to make an issue by the British Treasury and I was told, not by a member of the ignorant and financially unreasonable public, but by a very careful and clever Scotsman and banker, that he had subscribed for a large number of shares because the fact that it had received Treasury sanction showed that it must be a good thing. If this is the impression conveyed upon the mind of a highly trained financial expert, it is obvious that the guileless Clerk in Holy Orders with a large family and a craving for high dividends is still more likely to be misled into the delusion that what the Treasury allows it virtually guarantees.

And this argument, though not so strong in the eyes of the general public if such regulation is exercised by a Stock Exchange Committee as if it is

performed by the Government, nevertheless remains a thing to be carefully considered. If once a Stock Exchange indulges in more than merely formal examination of the companies and securities that it is asked to admit to dealings within its walls, it begins to accept responsibility before the public which is certain to be much greater in the mind of the public than it can possibly be in the view of the Committee or other ruling body.

Freedom has made London the world-wide market for securities of all kinds. It has also made possible much swindling, large loss to the public and many gains to the light-fingered camp-followers of the financial army. The question is, whether finance can deal with these camp-followers whose depredations on the public are continually ascribed to it, and that not without some justification, because they work through the abuse of the forms of the best finance. The old-fashioned idea that if the public is fool enough to come into the market and deal in any gold bricks that are manufactured for its edification, then the public has only to thank itself for its losses, is absolutely sound as a matter of ethical and economic theory, but it produces results which do harm, and if finance can see a way of modifying it and giving the public a certain amount of protection without too much sacrifice of freedom, something will have been done to make the future of finance cleaner, more comfortable and more profitable for the noisome insects that lurk in the chinks of the fabric.

Then as to speculation and time bargains. Some moralists tell us that it would be much better for the public if all speculation by means of time bargains was controlled out of existence. In other words, that the system by which a man can buy securities which he does not mean to pay for, or sell securities that he does not mean to deliver, in the hope of closing the bargain a week hence, or a month hence, or a year hence at a profit, should be done away with.

In the first place, even if this were done you would not stop speculation in the sense in which I am using the word—that is to say, the purchase of securities, not with a view to getting a steady revenue from them, but with the hope of a rise in price. It would merely mean that the speculator, instead of buying 1,000 rubber shares in what is called the "Sixpenny Bazaar," trusting to be able to carry them over in the market until he either is able to take a profit or is compelled by disgust to cut a loss, would buy a much smaller quantity and pay for them. His risk of loss would be much the same. The moral obliquity of the transaction, if any, has no relation with its arithmetic, so that such an attempt to control speculation would fail in its object of preventing people from losing money and from being naughty.

Moreover, is speculation naughty? It is a very stupid way of losing one's money, because the odds are heavily against the amateur in gambling in a market which is always likely to be ringed and con-

trolled by professionals, who know every move in the game, and have access to early information, and means of manufacturing and putting it about if there is none to be got. Nevertheless, backing one's luck is a thing which has to be done continually through life. Life itself is largely a gamble against incalculable forces. The desire to gamble is almost universal and, within reasonable limits, legitimate. The more it is repressed and frowned on by respectability the more the public's craving for it will be provided for by unscrupulous touts and the financial equivalents of street-corner bookmakers. Speculation, moreover, carries with it the distinct economic advantage that it makes a market freer and steadies the level of prices. These securities are most easily, quickly, and cheaply dealt in, in which a speculative account is open and consequently a big business is being transacted. In the long run and on the average the speculator loses his money. By doing so he provides facilities for investors, and gives steadiness to markets.

# CHAPTER VII

## INTERNATIONAL CURRENCY

So far we have considered these problems of finance chiefly from the point of view of their working and effect at home. When we come to look at them from an international point of view they become more difficult, more complicated and more interesting. Though it is always dangerous to prophesy, there seems to be no doubt that the result of the present world crisis which has already knit most of the world together for purposes of mutual protection and destruction, will knit it still more closely together in the future; and we may even hope that, instead of its being divided into two hostile camps, it will be made into one great union for mutual co-operation in the great work of development.

If this be so, it is very necessary that we should, all of us, learn to think, as far as we can, in terms of world-wide progress. Thinking imperially was a big thing to do a few years ago, but great and splendid as the British Empire is, there is something still more great and splendid about the idea of a league of nations, leagued together to promote prosperity and progress, breaking down barriers instead of setting them up and combining with one

another in doing the best work to improve the material and other welfare of mankind.

International currency and the means by which individuals in one nation make payments to those in others thus become a matter of even greater importance than before in the light of the new sun of civilization which we hope to see rise. International currency arrangements are one of the devices in which business men have shown the most successful ingenuity in solving a very difficult problem. In time of peace the machinery worked with extraordinary smoothness and success. Payments were made for the huge amount of goods and services constantly exchanged between nations by an ingenious mechanism of paper money largely uncontrolled and not even understood by Governments, with the occasional assistance of shipments from one country to another of gold coin or bullion when the paper and credit machinery did not suffice to complete the business.

The foundation of this machinery is the Bill of Exchange already referred to in Chapter II as a specialised form of currency, the use of which is largely restricted to business men and financiers and is seldom handled by the general public in its retail purchases. As was then pointed out, a Bill of Exchange is in essence simply an order to pay, and the cheques with which we meet our family expenses are merely a form of the Bill of Exchange, payable on demand and drawn on a bank.

In order to instruct our bankers to pay so many

pounds, shillings and pence to our butchers we must have obtained the right to do so either by depositing money with the bank or by getting a loan from it in order to give us the right to draw.

In its original form the Bill of Exchange was an order exercised by somebody who had acquired the right to instruct another person to pay money by selling him goods or rendering him some services for which he was liable to pay, or, in some cases, merely because the drawer of the Bill considered that the party drawn upon was in duty bound to meet it, as in the example when English monasteries and abbeys had Bills drawn upon them by a Pope who wanted to raise the wind for war-like purposes. In this case the Bills were drawn, and the unfortunate clergy drawn upon were informed that they would be excommunicated if they did not accept and meet them.

More usually the seller of the goods shipped his produce, say from London to Damascus, and drew a Bill of Exchange on his Levantine buyer, ordering him to pay the price of the goods either to the seller or to the order of anybody else whom the seller might name. As the Bill was usually drawn payable two, three or six months after sight or date, that is to say, either after the day on which the party drawn on saw and accepted the Bill or after the day on which the drawer of the Bill drew it, there was thus a period of time granted during which the buyer of the goods would be able to dispose of them either in the shape in which they were

received or, in the case of raw material, after working them up into manufactured articles.

It is these Bills of Exchange, drawn by the shippers of goods or the providers of services in one country on people in another country, who are buying the goods or using the services, that have hitherto constituted the chief supply of international currency. If an English merchant shipped coal to Scandinavia he has a Bill of Exchange on Scandinavia to dispose of. If the shipment consists of £10,000 worth of coal, he would draw on Mr. Olafsen of Christiania for, say, 180,000 Norwegian kroner. The Bill would then run: "Two months after sight, pay ourselves or order the sum of 180,000 kroner for 10,000 tons of coal shipped per S.S. Vulcan," or words to that effect.

Whatever the article sold or whatever the services rendered by English traders to a foreign country, all items of visible or invisible export either produce Bills of Exchange on the countries to which the goods and services go, or make it necessary for somebody in the country to which the goods and services go, to buy a Bill on London with which to complete payment. For example, the more usual mode by which the payment for the export of coal would be made would be for Mr. Olafsen to buy from his banker in Christiania a sterling Bill on London and remit it to the seller of the coal. This he would only be able to do if the Norwegian timber merchants, fish merchants and other exporters of Norwegian produce, had been selling goods to

England and consequently had been able to draw Bills on their English buyers. If a Norwegian merchant had sent £10,000 worth of timber to a London importer, Olafsen's banker would be able to buy his sterling Bill on London, which he could send to the Hull coal merchant who could dispose of it through his banker by selling it in the London discount market. If the Bill were payable at sight it would, of course, be presented for immediate payment. If it were drawn payable some months hence, it would first have to be accepted by the timber merchant, or any banker or finance house which he had induced to accept Bills on his behalf by the payment of the usual commission. It would then be sold through the machinery of the Discount Market and probably finally be held as an investment by some English bank until it became due at maturity.

By this highly ingenious machinery for exchange between one country and another all goods or services produce the currency in which to pay for themselves, and as long as a fairly even balance is maintained in the mutual indebtedness of any two countries their exchanges of goods and services can be paid for by this simple process of creating currency for the purpose with extraordinary ease and smoothness.

There is no need to enter into a detailed exposition of the various kinds of goods and services exchanged between countries. It has been done over and over again in the text-books, and all that

we have to bear in mind for the present is that many things come into the question of the mutual indebtedness of the great trading countries of the world besides the actual volume of tangible commodities shipped or transferred from one country to another.

Reference was made in a sentence above to visible and invisible exports. Visible exports, of course, are the articles of merchandise actually shipped or transferred. They are recorded in the statistical returns, first of the shipping country and afterwards of the country to which they go, but on the way they have become more valuable, having come across the sea from the place where they were made to the place where they were wanted. Consequently, we find that if we add up the imports and exports of all the great trading countries together they apparently import in the aggregate a much larger amount than they export. Clearly this is not so. The amount imported and exported must actually balance, but the imports are more valuable for the reason already given, because they have been shipped to the country where they are wanted, and consequently the cost of shipment and insurance against marine and other risks has to be added to the value with which they left the country of origin. In other words, if coal comes from Hull to Christiania on a British ship, this is a case both of visible and invisible export. The coal is the visible export, the services rendered by the English shipping company is the invisible ex-

port, and, if the insurance of the goods while in transit has been effected by an English company, that is another invisible export to be added to the value of the coal before it reaches its buyer.

Another obvious kind of invisible export is provided by those countries which every year are thronged by visitors from abroad, the most notable examples of which are France, Switzerland and Italy and, to a less extent, England and Scotland. On this account England, however, probably imports more than she exports. That is to say the British, in normal times travel abroad in larger quantities and spend more money in so doing than is the case with regard to the number and spending powers of the foreigners who come to our shores.

England imports from Europe and other places to which her citizens travel, health, change of scenery and the other so-called pleasures of travel. The Englishmen travelled to the other countries to fetch these imports, and the money that they spent abroad has to be constantly made good by the shipment of English goods either to the countries in which the money is spent or to other countries so as to produce credits for England, or else the sums to which England is liable, owing to the spending of her citizens abroad, have to be set off against the sums owed by other countries to England on account of interest payable for loans made in the past or on other accounts.

It was calculated that in the days before the war the citizens of the United States used to spend

about 50 millions sterling per annum on travelling in Europe, and so the war which broke out in Europe in 1914 compelled the Americans to save practically the whole of the sum hitherto devoted to this form of invisible export, because it became too dangerous for travel in Europe to continue.

Reference has already been made to interest on loans. Lending money abroad is another form of invisible export. If England, as she used in old times, takes up an issue of Pennsylvania Railroad Bonds, say for 25 million dollars, the result is that America exports to England the Pennsylvania Railway Company's promises to pay for that amount and England has to pay for these promises to pay, which her investors put away into their tin boxes, by shipping goods to America or by setting the transaction off against any payment that may be due from America to her. Afterwards, every half-year, when the interest on these bonds falls due, England exports the coupons, or claims to interest, to America and America has to ship goods in payment of them. When the Bonds fall due for repayment, England sends the Bonds back again to be paid for by America, and so whenever one country invests money in another it first of all makes an invisible import by importing promises to pay; it then, as long as these promises to pay are outstanding, makes invisible exports periodically in the form of claims for interest and finally makes an invisible export by returning the promises to pay to be met on maturity.

There is thus at all times an enormous volume of cross-entries in the international accounts. Very often two nations will be shipping to one another actually the same kind of produce; for instance, French ladies sometimes buy tailor-made clothes, when tailor-made clothes are the fashion, in London, while, at the same time, English ladies are buying what are called creations and costumes from the artists who produce them in Paris.

England, with the biggest and most widely distributed trade of any country in the world, had a particularly complicated trade balance. Before the war she had what is called an "adverse trade balance" with regard to visible trade, that is, with regard to tangible goods such as can be shipped and classified in a schedule, of 130 millions, this being the amount by which her imports exceeded her exports. Quite lately she was assured by a colonial Premier that she was thereby ruining herself because this balance had to be paid for in golden sovereigns. This, of course, was untrue. On the other side of the account she could put, according to estimates made by statisticians, about 200 millions a year for interest on loans previously made abroad, about 100 millions a year for the cost of the services of her merchant ships, and 30 or 40 millions a year for her insurance premiums, bankers' commissions and other invisible services of that sort. On the invisible trade she thus had a very large balance in hand, and this balance she used to use by investing it abroad and so continually in-

creasing the amount due to her in interest which other countries had to pay by the shipment of goods. Every time a country makes an export, visible or invisible, she thus creates a claim on some other country, and every time she buys something abroad, the selling country has a claim upon her and, as long as a fair approach to equilibrium is maintained, the supply of bills of exchange will be about equal to the demand, and what is called the rates of exchange will be somewhere near the normal level. It is not necessary that one country should anything like balance its trade with each of the other countries of which it is a customer. For instance, Canada used habitually to buy from America much more goods than she sold to her. On the other hand, Canada used to sell to England much more goods than she bought from her, and so Canada was always able to pay for the American produce that she bought by the bills on London which her sales of wheat and other produce to England enabled her to draw.

By this system of balancing the claims on and due to the various countries of the world, owing to their exchanges of goods and services, international remittance was carried out with astonishing ease and simplicity.

There were, of course, occasions in the course of this world-wide exchange of goods and services on which one country or another would have too big a balance on the credit or the debit side. For example, in times before the war it was a normal

experience for America to owe more to Europe in the first eight months or so of the year and to have a balance in her favour during the last four. This happened because America's chief exports in those times consisted of the produce of the earth which was not harvested and shipped until the autumn.

During the first eight months of the year America had to pay interest to Europe on money invested in her industries and railroads by the capitalists of the Old World, had to pay for goods imported and also had to finance the great expenditure of American travellers on the Continent.

During the last four months the shipping of her cereal and cotton crops turned the balance on the other side, and America normally had more money to take from Europe than she had to pay.

This seasonal deficiency in the early part of the year turned the Rate of Exchange, that is to say, the price at which bills on London could be sold in the New York market against America and in favour of London. The parity price for these Bills was $4.86.6 to the pound sterling. This is the Rate which expresses the relative gold value of the coinage of the two countries.

In the first two-thirds of the year, owing to the preponderance of payment that America had to make to Europe, the demand for Bills on London would naturally be greater than supply, for, it will be remembered that a country normally produces Bills on foreign centres by selling goods and services to foreigners, so giving it a right to order for-

eigners to pay money to it or to any other party whom it may name.

For the reasons above given during the first eight months of the year Bills on London would be wanted in New York, owing to the payments that America had to make, and would be scarce, owing to the fact that her staple exports would not, at that time, be coming forward freely. Consequently the spirited bidding of those who had payments to make in Europe would force the price of Bills on London up and the Rate of Exchange would tend to rise above the parity price. This tendency would be met and coped with to a great extent by the creation of bills, not against any actual shipment of produce, but through credit arrangements between New York and London. By arrangement between American and English bankers, American bankers would draw Bills on their London correspondents, which Bills represented in fact a loan from the English firm to the American.

By this means, at a time when Bills on London were wanted in New York, they were called into being by the credit machinery and so steadied the Rate of Exchange by increasing the supply of Bills at a time when they were scarce, and, artificially but most efficaciously, met the needs of those who had remittances to make to London. In effect New York was shipping promises to pay instead of goods and so filling the gap in the Exchange market.

When the autumn came and the shipping of America's produce brought a flood of cotton and

wheat Bills into the market, the Rate of Exchange would tend to fall rapidly and the same credit operation which had steadied the upward market in the early part of the year would steady its relapse in the last four months, because the New York bankers who had created Bills on credit to meet the demand in the early part of the year would now have to buy Bills to a corresponding amount and send them to their London correspondents to pay the debts thus contracted.

A concrete example always makes these things clearer. We will suppose that in May, when the first flight of American visitors to Europe is beginning to increase the demand for payments from New York to London, the Rate of Exchange goes up to $4.88½; then an American firm draws Bills for a quarter of a million sterling on various London correspondents, supplies the demand in New York of those who have European payments to make and keeps the Rate of Exchange from rising too rapidly. In September, when the wheat harvest and the cotton crop are beginning to produce the usual flood of Bills on London and the Exchange has gone down to $4.85½, the New York firm is able to buy up Bills on London for a quarter of a million, so again steadying the Rate of Exchange and preventing a further fall, and ships the Bills to its London correspondents, so redeeming the debt.

Finance Bills of this kind, drawn in anticipation of the usual seasonal movements of trade, thus

provided a very real benefit to merchants and others who have payments to make, by narrowing the fluctuations in Rates of Exchange, and they also provided international banking with profits, which, however, were cut extremely fine by the keenness of competition.

Like most of the other ingenious devices of finance this arrangement was liable to abuse, for international banking houses, having discovered how easily and comfortably Bills could be drawn on one another's credit and discounted in the financial centres of the world, sometimes made use of these facilities for the financing of operations, such as Stock Exchange speculation, which could not be counted on with the same confidence as the movements of the harvests. Sometimes also they used them for purposes, such as the provision of fixed capital for industry, which was an abuse of the Bill of Exchange, the justification for which is a shipment of goods coming forward for consumption, or the provision of services, now or in the immediate future.

Apart from this liability to err which is shared by most human institutions, the machinery of Exchange was carried on with extraordinary efficiency, and by far the greater part of the world's exchanges of goods and services was thus financed by currencies specially created for each transaction and cancelled when the transaction was over and the Bill had, as the phrase was, "paid itself," by the selling of goods.

There were times, however, when even with the help of finance Bills specially created to fill the seasonal gap, the demand for Bills ran so far ahead of the supply that shipments of gold became necessary. This happened when the Rate of Exchange, that is to say, the price of Bills, rose or fell to such a point that gold became the cheaper form of remittance. To go back to our London and New York example, if, in the early months of the year the demand for remittances to London forced the price in New York up to $4.88¾, then it was cheaper to send gold, since the cost of shipment was then usually less than the difference between this Rate and the parity price of $4.86.6.

Books on Foreign Exchange continually talk as if those who had payments to make in London would calculate for themselves the difference between the price at which they could buy the Bill on London and the terms on which they could ship gold. As a matter of practical fact the shipment of gold was chiefly in the hands of experts provided with the highly technical knowledge required for this complicated business. They, when the Rate of Exchange went up to what is called "gold point," that is to say, the price at which a shipment of gold is the cheaper form of remittance, would themselves send gold across and so, by making this actual shipment of valuable produce, would have a claim upon London to sell, and so would be in a position to feed the demand of those who wanted to buy remittances.

The same process would happen on the other side of the account in the autumn months, when Bills on London were too plentiful to be absorbed by the normal demand on the part of those who had remittances to make. When the price went down to the importing gold point, it would pay those accustomed to the business of shipping gold to bring gold across to America, buying Bills on London in the New York Exchange market to provide them with the means of paying for it.

Fluctuations in the Exchange were thus originally and chiefly based on the international exchanges of goods and services, but, as we have seen, they were complicated, checked and modified by the machinery of credit, which brought Bills into being when they were wanted and produced a demand for them when they were plentiful. These credit operations were also employed to check gold movements, when they arrived at a point which the exporting country considered inconvenient, by stimulating the export of promises to pay.

For example, when the course of Exchange was against London in the autumn season, it was customary for the Bank of England to raise the Rate of discount current in London by putting up its own official Rate and taking measures, if necessary, to bring the market Rate up after it, the market Rate being the Rate at which Bills could be discounted by the London bill brokers. The effect of thus raising the Rate of discount in London would be that American bankers and others

who had control of the funds which the American shipments of produce were putting into American hands, would be inclined to leave these funds in London instead of selling Bills against them in the Exchange market in New York and so depressing the rate of exchange in New York towards "gold point." For example, a New Orleans banker, being in possession of a large number of Bills on London, produced by shipments of cotton made by his customers to England, would, if the rate of discount in London were raised from 4 to 5%, be less inclined to turn his Bills into cash, because, owing to the rise in the rate of discount, he would get less cash for them. Consequently, he would be inclined to hold the bills as an investment instead of turning them into cash and selling sight drafts against them; and the market in Exchange would be, to that extent, steadied. At the same time American dealers in money would be encouraged to buy bills payable at sight, so putting themselves in funds in London, and investing the proceeds in London's discount market.

By these means, by, in effect, raising the rate that the London market was prepared to pay for money, foreign holders of claims on London would be discouraged from presenting them and foreign holders of money would be encouraged to make remittances to London in order to take advantage of the higher Rate.

Apart from this power of attracting foreign money by changes in the ruling Rate of discount,

creditor countries such as England and France before the war were able, at any time, to turn the Exchanges of the world in their favour by calling in money that they had lent to other countries or simply by ceasing to invest abroad.

As we saw above in our examination of England's account with her foreign customers, she had an annual surplus in her favour, resulting from her exchange of goods and services with the rest of the world, of something like 200 millions sterling which she used to invest in foreign countries. If she chose to stop this process, which those in charge of her monetary machine could encourage her to do by raising the rate of interest at home, the Exchanges of the world would tend inevitably to move in her favour. If, as happened at the beginning of the war, she not only stopped the process of investing abroad, but called in all the short credits which she had outstanding in foreign countries, the Exchanges of the world went in her favour with such a mighty rush that they broke the machinery.

Countries which are not in this comfortable position have devised an ingenious means for being able to regulate the Exchanges when they move against them, by the establishment of what is called "a gold exchange standard." Under this system the country either keeps a balance in some important foreign centre or keeps in its own hands a steadily maintained store of claims upon some foreign centre. For example, before the war it was customary for the Austrian State Bank continually

to hold a large amount of Bills on London. If the Exchange between Vienna and London went in favour of the latter more rapidly than seemed convenient to the former, the State Bank could check the movement by supplying the market with sterling Bills.

India and Brazil used to keep large balances in London with a view to the same object, that is to say, the power of drawing upon these balances and so providing the local market in Bombay or Rio de Janeiro with Bills on London if there were too great a scarcity of them. Mexico kept a balance in New York for the same reasons. The system works admirably in normal times, and as long as the balance of trade does not go too violently against the country which employs it, and as long as the country's credit is good enough to enable finance bills to be created, if necessary, to fill the gap. It broke down, however, in Mexico when plunged in Civil War, so that her power of export was diminished and her credit was impaired.

It is not a panacea for Exchange diseases and no panacea against these ills can be invented for a country which outruns the constable beyond a certain point, but it is a highly useful and beneficial system when carefully regulated. By its means the Government is able to fix a local Rate of Exchange and maintain it within reasonable limits by the sale and purchase of drafts as occasion may demand. The system, in fact, has worked so well for small and financially dependent countries that

it has been suggested that it might be adopted with advantage by the leading financial countries such as America, England and France, that their Governments should establish substantial balances with one another and with other countries and should take over the whole machinery of international remittance.

Some even go so far as to suggest that some sort of international Bank Note should be invented and that the golden idol should be knocked off its pedestal and handed over to be used up by jewellers, picture framers and dentists. It seems to me that there are many objections to these rather idealist proposals. Until we have abolished war no country would care to have a large balance in any centre where it might be liable to sequestration if war happened to break out.

The suggestion that the machinery of international remittance should be put into the hands of Government calls up a vision full of shuddering horror, of red tape, forms to be filled in and delays and circumlocution which might be a very serious drag on business. It is also very safe to expect, at least from previous experience of English enterprise as managed by Government, that the business would be carried on at a loss, at the expense of the taxpayers of the countries involved. Nevertheless, there is much to be said for closer co-operation between the great financial centres of the Eastern and Western hemisphere, and a beginning in this direction has already been made by the knitting of

closer relations between the Federal Reserve Board of the United States and the Bank of England in London.

If, and when, a league of nations has been formed and formally established it may perhaps be possible to consider the establishment of some international form of paper currency which will pass all over the world or at least in those countries included in the league; but the difficulties involved by such a system are so great and there are so many unavoidable difficulties ahead, to be faced in the period of reconstruction, that it seems unwise to add to them by turning loose the international currency reformer.

## CHAPTER VIII

### INVESTMENT ABROAD

WHEN the investor sends his money abroad he, as a general rule, takes greater risks and expects to earn a higher rate of interest or of profit on his investment. The more enterprising the nature of the operation involved by sending money to fertilize the uttermost parts of the earth, the greater is the responsibility thrown upon the financial leaders who handle the business. With a view to the eternal craving of the ordinary man for short-cuts to fortune, it follows that the more easily he is tempted to send money over-sea, the more care has to be taken by those who provide investment in Loans and Companies abroad and gather in money from their fellow-countrymen to finance them.

Many people think that when the war is over very little investment abroad will be done by any of the great lending countries for some years to come. This belief is based on the expectation that, in the first place, there will be a great scarcity of capital as compared with the demand for it for the development of home industries in all countries; that, in the second, the investor, after the experiences of

the present war on the part of those who have been unfortunate enough to have had money invested in enemy countries, will prefer henceforward to keep his money at home; and that, in the third place, official regulation will exercise strict control over the issue of foreign securities in the great money-lending centres.

None of these assumptions is necessarily true. It is quite probable that each of them may exercise a certain amount of influence, but to expect that they will be strong enough altogether to dam the stream of foreign investment is perhaps too sweeping an assumption.

With regard to Number 1, it is certainly true that in all the great money-lending countries there is a great deal of work at home clamouring to be done, but being held up by the demands on the money market for war purposes, and it is very likely true that the demand for capital for these home purposes will come first, either owing to sentiment or to regulation, before the outward flow of capital is resumed.

On the other hand, the assumption that capital will necessarily be very scarce after the war is one that remains to be proved. Capital after all, as has been pointed out in an earlier chapter, is merely the margin of current production which is available for the equipment of industry after the immediate needs of the population have been satisfied, and if, as is quite possible, the industrial lessons of the war are well and truly learnt and the im-

proved organisation and efficiency are made use of in order to promote a great increase in the output of goods for peace purposes, and if, at the same time, the needs of the community for immediate consumption are still modified by the austere ideals set up by the war, then it is quite possible that the supply of capital may be very considerable; and that it may be actually encouraged to go abroad both officially and unofficially, in order to stimulate the purchasing power of the more backward countries, as necessarily follows when capital is being placed freely abroad. In other words, when the creditor countries lend, their financiers lend, in effect, the goods which their industrial machinery is producing. The more the financiers lend, the keener is the demand for the commodities produced by industry, because the borrowing countries are thus able to supply themselves with commodities, giving in payment the money invested by the financiers in the borrowers' promises to pay some day. A foreign Government sells its bonds to our investors and uses our investors' money to pay for imported goods.

As to Number 2, the reluctance of investors to go abroad after the experiences of the present war, this will certainly be a very strong bar to over-seas investment if the war should end in such a way that there is any likelihood, or even possibility, of its recurrence. Unfortunate English shareholders, for example, in the Imperial Continental Gas Company will have had reason to be sorry that they

made what, at the time, looked like a very judicious investment. The Company was one of the most successful and best managed in the world and its stock used to pay a regular dividend of 9% and stand at a very high premium. Unfortunately for its shareholders one of the most successful parts of the Company's enterprise was the gas that it supplied to the City of Berlin and other German towns; consequently, since the war broke out, the Company has been unable to bring home a considerable proportion of its revenue, and, in spite of the very great financial strength that it had built up during many years of well conducted enterprise before the war, its shareholders have received no dividend since May, 1915.

If, then, the war ends with conditions of diplomacy and international politics which make any repetition of the present barbarism possible, it will be the natural instinct of most cautious investors to keep their money at home, or at least only to place it in countries with which they believe their own nation can never, by any possibility, quarrel.

If, on the other hand, as we all hope, the present war ends in such a way that the danger of conflict on such a scale is made definitely impossible for the future, and if, at the same time, there is a great development in international amity and co-operation, it seems probable that there will be a great movement in the direction of freer interchanges of commodities and services between the nations and

consequently of an expansion of international investment.

With regard to Number 3, the official regulation of investment at home and abroad, that certainly seems to be inevitable for a time. In all the countries that now have been long at war business men of all kinds, financiers, industrialists, and commercial men, seem to be fairly unanimous in hoping that the restrictions in control, with which they have struggled during the course of the war, will be removed as soon as possible, but, with regard to one matter there seems to be an overwhelming necessity for regulation for some time after the war and that is with regard to imports.

Problems of exchange seem to be likely, when the war is over, to be so important, at least among those countries which have any regard to their financial prestige abroad, that it will be hardly possible for the State to throw the door wide open and to say that goods are to be poured into the country as fast as those who have money to spend choose to spend it upon them, without any regard to the desirability of the kind of goods that the private buyer is importing.

With regard to visible goods this need for regulation will be emphasised by the scarcity of shipping space that seems likely to produce a difficult problem when the war is over.

Invisible imports, such as promises to pay, are not affected by this part of the problem, but they will have a very considerable effect upon exchange

and may therefore be considered likely to remain for some time under official or semi-official control. The commonly used phrase, "the export of capital," is perhaps rather likely to mislead the careless observer as to what really happens when the lending country makes an advance to an over-sea borrower. The promises to pay, which are the tangible expression of the capital lent, are not exported but imported, and if we think, not of export of capital but of import of securities, it thus becomes clear the process of investment abroad, which implies the importing of securities, necessarily has the same effect upon the country's exchange as any other import, namely, turning the exchange against the importing country.

For example, if Brazil exports one million pounds' worth of Brazilian Bonds, representing a loan which is being granted by England to Brazil, the effect of the operation is that England has to pay Brazil a million or place a million at Brazil's disposal. Brazil has Bills on England for a million to sell and this sale would tend to turn the exchange in favour of Brazil and against England. For these reasons it may be that in the case of those countries which make it a point of honour to pay attention to the question of the Rate of Exchange and to financial prestige, regulation of over-seas investments may be desirable from this point of view, at any rate in the difficult first few months that may follow the end of the war, and it is also

possible that if the demands of home enterprise for capital are insistent and unsatisfied, political and other pressure may be brought to bear upon the Governments so that the needs of the home market for capital may be supplied first. Nevertheless, it will probably soon be recognised that in order to join freely in the great international trade movement which may, if all goes well, follow the end of the war, it will be necessary for every nation to put as little bar as possible upon the free import of securities, and, as has been pointed out above, since it is quite possible that the supply of capital may be much freer than is expected in certain quarters, the need for official regulation may soon be brought to an end by the weight of purely economic factors.

It thus appears that the expected suspension of foreign investment when the war is over is based on assumptions, none of which are certain and all of which, though they may perhaps be called probable, are not likely to last long. If this be so, it follows that those who handle the machinery of finance will soon be busy again on this most difficult and responsible part of their work, namely, the provision of capital for foreign countries from those in which more is saved than is required for home purposes.

It is sometimes contended that the creditor countries in the past, especially France and England, have developed this business of international investment at the expense of those who wanted and

could not get capital for use at home; and it is argued that what happened before the war is an additional reason for the continuance, not for a time only, but for all time, of official regulation of capital issues, so that money which might be used at home shall not go abroad, but shall stay at home and cheapen the supply for home use.

This subject is extremely complicated and difficult, because it is so closely associated with problems of international politics that it is difficult to regard it from the purely economic point of view. In fact, it is not possible or desirable so to regard it. We have to look at these things from the point of view of international interest.

It is perfectly true that when we lend money to other countries we assist their development and stimulate, in the first place, their demand for goods, which it is at least probable that we shall be asked to supply, and afterwards their demand for labour, which tends to help the process of emigration by which we, in England, have in the last century lost so many valuable citizens. It is at least possible that if we had lent less money abroad, our home industries would have been more cheaply supplied with capital and might therefore have been, by this time, on a more extensive scale, employing a larger volume of labour. On the other hand, if our capital had not gone abroad to fertilise the uttermost parts of the earth, the development of the total output of mankind's material energy would have been

much slower and the volume of goods continually poured into this country for the food and enjoyment of its inhabitants would have been very much less.

By our international investment policy before the war we helped to produce all kinds of goods all over the world in places in which they could be produced most freely and cheaply. Consequently in our time of need we were able to draw upon the rest of the world to supply us with things that we wanted for the war. Against which the opponents of the system can always reply that if we had not sent so much capital abroad we should have been in a position to rely much more on ourselves and much less on our over-seas sources of supply and consequently we should have been much less vulnerable by the attacks of the submarine. We might not have had such large contingents coming to our help from the Dominions, but we might have been able to produce a larger population at home ready to go into the firing line. Perhaps, but when we remember how much virgin soil has been opened up in the last century by our investments abroad we have to ackuowledge that without them there would have been much less production and consequently much fewer people in existence and bound to us by trade relations.

This is a question which can be argued round indefinitely It becomes finally, like a currency problem or a religious conviction, almost a matter of belief, concerning which demonstration by argu-

ment is impossible. But at least it may be pointed out that the experiences of the present summer* show that we might, if we had tried to bring up a larger population on our own resources, have been liable to natural and seasonal reverses which might have been almost as unpleasant in their consequences as the submarine.

The question we have to decide is whether it is better for each nation to do as much as it can and grow as much as it can for itself within its own borders, or to reach out the largest possible number of tendrils and branches all over the world, so as to get as much nourishment as possible from foreign soils and to make as many connections as may be with foreign consumers and customers. Once again we find that the end of the war, the way in which this war ends, will go a long way towards answering the question.

If it ends in the wrong way, to be followed first by a pause of exhaustion and then by a period of hasty armament and then by another war, with all the present weapons of destruction very much more efficient and destructive, in that case it is almost idle to consider about any of these economic problems, for the only problem before any nation will be, how to make itself all sting, so as to be able to join most efficiently in the great stinging match which will destroy such civilisation as now exists.

If President Wilson's League of Nations is real-

* Written in 1917.

ised into such a shape as many quite practical people are now sketching in their dreams, then it would seem that all the old-fashioned contentions in favour of the utmost economic freedom and the readiest possible movement of capital, goods, services, ideas and men from one country to another will have come back to their old strength and much more than their old strength.

The weakness of the economic argument, that whatever was best for the economic progress of mankind and for the greatest possible increase in the world's material output was also best for any individual nation which had any part in international trade, was based upon the fact that there was always danger of a rupture of the whole economic machine by some ridiculous barbarism in the shape of war initiated by some ambitious potentate. If we are to be quit of this danger in future and mankind is to be free to develop the resources of the world in the places and in the manner that is most convenient and conducive to their output, then the international ideal which has served men so well for many centuries, by lifting them out of themselves and their own petty interests into something wider, will begin to look very narrow and parochial by the side of the great world-wide ideal which President Wilson has put before the world as the thing to be achieved by the present war.

If this be so, then it is the business of those who manage the machinery of finance to take good care,

working with the experience of the past, that international investment shall be free in the future from the dark stains that have marked its past career. Properly conducted international finance is a very strong power for good. Its effect is that the citizens of one country get a good investment, and that the citizens of another country get resources that they need in order to develop its productive power. Thereby the total output of the world's material goods is increased, and the power of mankind to produce and enjoy the good things of the earth is multiplied.

On the whole, international finance can claim that its work has been clean and beneficial. If it had not been so it could not have gone on, because it is continually tried by the strictly material, but nevertheless searching, test of its ability to pay both the parties who engage in it. It might be that this test might in some cases be applied, and survived, although at the same time there might be moral considerations which would still leave a sceptical critic unsatisfied. But these things cannot happen often or continuously. Unless the exchange of capital between nations is, on the whole, and in the long run, beneficial to both parties there is no reason why either of them should engage in it. The test is constantly applied by which finance is asked —Has this application of capital produced that increase in the output of material goods which is its economic justification? If it has not, then the necessary resources for meeting the interest or

profit on the capital applied will not be forthcoming. Either the lender will have to go without his interest, or the borrower will find himself hard put to it to pay it. Whenever it is found that the lender and the borrower are both satisfied, we may be certain that the material goods which are required to provide interest on capital invested have been delivered.

Nevertheless, though on the whole there can be no doubt that international finance has done enormous service in quickening mankind's production and enjoyment and in uniting the whole world into one great cosmopolitan market, it is equally certain that many grave errors have been committed in the past in this process of the international exchange of capital, and now that the whole financial machine is working under very close and critical scrutiny, it is very desirable to make use of these lessons of the past to avoid similar scandals in the future.

If we are about to build a new world and make a fresh start in most departments of life, it is essential that those who handle capital should see that it is well and cleanly used, or we are only too likely to find the whole business handed over to Government Departments, with the lamentable results that may be expected when Government officials are asked to do anything outside their usual routine.

Great as is the power of good finance for good, the power of bad finance for rottenness, both in

the borrowing country and in the lender, is almost unlimited. In the case of the lender, when questionable securities are handled and offered to the public, the business will be done by third-rate firms, because firms of high standing would not touch it, and the methods of third-rate firms are likely to be more than questionable. Big underwriting commissions, extravagant advertising in the press, perhaps a certain amount of actually corrupt puffing, market manœuvres, all the machinery, in short, by which bad wares are placed upon a greedy and gullible public, is set to work at its full capacity. All the speculative allurements of a cheap security with high yield of interest are displayed to distract the public from the austere path of sound finance. When the day of reckoning comes there is an outburst of anger against reckless and improvident borrowers, who are alleged to have taken good money without any intention of meeting the service of the debt. Bondholders then forget the speculative risk that was obviously expressed in the price at which the securities were offered, and regard themselves as virtuous investors who have been tricked out of their money, whereas they are in fact foolish speculators who have made a loss which must have been an obvious possibility at the time when they entered into the gamble.

Much is heard about the levity and improvidence of economically backward countries, and their readiness to enter into liabilities which they cannot possibly meet; little, if anything, is said about the

serious responsibility which attaches to everybody who lends money to people who do not know how to use it, without the exercise of proper care to see that they use it in the right way. A process of composition involving a reduction in the rate of interest, and a scaling down of the capital of the debt, is the usual sequel of these recriminations. A few people learn a lesson, which they probably very shortly forget, and so the game goes on.

In the borrowing country the results are probably even more evil. When a Government is encouraged, by the ease with which it can borrow abroad, continually to outrun the constable without any care for balancing its budget, direct encouragement is given to political and other corruption and to forms of collective extravagance which are still worse in their economic results. When the time comes when the borrowing process cannot be repeated, and the Government is no longer able to fill the gap between its revenue and expenditure by raising money abroad, then the country finds itself faced with the necessity either for imposing taxation on a scale of great severity, and shipping continually to the borrowing country a large proportion of its natural produce, or, as is more likely, for making a composition with its creditors, in the course of which it repays their criticisms of its levity and improvidence with plentiful charges of exploitation and capitalistic blood-sucking. In such a case as this both parties lose, and the only gainers are the horde of greedy or questionable people

who have benefited by both sides of the bargain. In the borrowing country greedy politicians have probably feathered their nests, perhaps contractors have made a fortune out of constructing unnecessary public works at extravagant prices. In the lending country touts and puffs, during a brief but glorious harvest, have swum in champagne.

The by-products of bad finance are an extraordinarily disgusting spectacle. This being so, the problem that has to be solved by those responsible for our financial machinery is this: How can they keep it clean and prevent it creating these evil products? The answer is very difficult. In the past the action taken by the leaders of finance in the great creditor countries, which were England and France, has been purely negative. They refused to handle any business which they believed to be bad. It may have been that they sometimes erred on the side of taking too lenient a view, in criticising propositions put before them, from the point of view of the economic good of the borrowing country. As long as the charge involved by the new debt was amply covered it did not seem to them to be their business to ask whether the money was going to be spent on increasing the country's productive power. For example, if a South American Government had come in old days to a syndicate of French banks, and a great English issuing house, with a proposition for a loan of a couple of millions sterling, or fifty million francs, and if, on the existing basis of revenue there was no question

that the reserve of this new debt was sufficiently well secured to justify these institutions in making an issue to the public that followed their lead, they would probably not have enquired too closely concerning the use to which the money was going to be put. It would have been very difficult for them to do so, because economically backward States are extremely touchy about their financial position and their financial responsibilities. They naturally and inevitably resent any financial tutelage, and they consider, if they can offer a well secured loan and show that it has been duly authorised under the laws of the country, that that is all that the financial house to which they entrust the business has any right to ask. So that any house or bank which wanted to make stipulations, which would be in the interests of the country even more than of the future bondholders, would run a serious risk of losing the business, and of putting it into the hands of less particular and less scrupulous rivals, so doing nothing to prevent it being carried out, and only losing its profits for themselves and for the centre in which they worked.

Consequently, in times when capital was plentiful, competition between the issuing houses of different financial centres unquestionably offered inducements to the backward countries to borrow more than they needed, that is to say, more than was good for them, with ultimately the worst possible results for all parties concerned. The profits of the issuing house were handsome, and their pres-

tige was enhanced by the volume of this kind of business that they did so long as it was technically good, that is to say, so long as there was no default,

It may possibly be some years before this state of things returns, but the economic resources of the world have been shown by the war to be so tremendous that it will not do to rely with any certainty on a famine in the market for capital which will for some time to come make those who frequent it "forswear sack and live cleanly." Consequently it is not a day too soon for those who are concerned to think this problem out, and see their way through it. The real solution, as for all these problems which we are considering, is the terribly slow process of the economic education of the public. If the public could only be taught that loans to young countries are not good, either for the borrower or the lender, unless there is a reasonable certainty that the expenditure of the money by the borrower is going to be made in such a way that it will increase the country's industry or commerce to an extent sufficient to cover the service of the debt, then there would be no fear that third-rate issuing houses would make large profits by bringing out ill-secured loans in the markets of the world. Until that day comes probably all that can be required of our leaders of finance is that they themselves should set the very best example, refusing to handle any issue which itself comes within the description given above.

There will for some time to come be great op-

portunities for the placing of capital abroad under circumstances which fully justify it. There will be railways to be built, country to be opened up, ports and harbours to be constructed and deepened, all kinds of enterprise waiting to be done, the carrying out of which, if carried out cheaply and well, should add directly or indirectly to the power of the borrowing country to produce and transport more goods for the service of man. As loans are brought out for these purposes, it should be the business of those who handle them to see that these advantages are clearly set forth, so that the public may be taught to distinguish between issues made for these purposes and others which are not adorned by these qualities. The process will necessarily be slow, and we need not expect that the desire to grow rich in a hurry and without trouble will cease to mislead those who cherish it for many a generation. But it is only along these lines that international finance can be kept clean, and that capital sent from one country to another can be relied on not to fructify in corruption.

So far I have been dealing chiefly with the problems that arise when international finance is concerning itself with loans made to Governments. Exactly the same principles, of course, apply when the borrower is a municipality or any other public body. When we come to companies formed to carry out enterprise abroad the question is in some ways simpler, in others more complicated. It is simpler because a company has to rely upon its profit for

some enterprise which has to be profitable if that profit is to be earned. There is no question here of pledging the taxable capacity of a country, that elastic and elusive quantity which no one can test accurately. A company is formed to make a profit out of some definite operation, whether it be a railway, or a land scheme, or a mine; hence it follows that the economic test of economic results ought in all cases to be able to be applied with success. If any company comes forward without being able to show at least a fair chance of increasing the material output of the country in which it is going to operate, it will not get subscribers. On the other hand complications arise because this kind of concern is usually dealt with, except perhaps in the case of railway companies, by less exalted institutions than those which handle Government loans. Company securities, as has already been observed, are usually left rather to the small fry of finance, who have less reputation to lose than the leading houses, and, from the nature of the case and the more speculative species of their operations, they offer a high rate of profit, and so appeal to a more speculative public. There is in their case perhaps a still greater opportunity for friction and bitterness between the lender and the borrower of the capital than in the case of Government loans. If, for example, the native landowners find that they have sold their property to an alien institution which works it at a profit highly satisfactory to itself, they are apt to feel that they have been

hardly treated in the matter of the price paid. If, on the other hand, this price is such as does not give the exploiting company a chance of earning a profit, then those who put their money into it are likely to consider that somebody has swindled them, and the foreign seller of the property is a convenient scapegoat.

Difficulties also arise in the matter of the payment of the native workers for the company. If the payment of these workers is low according to European standards, humanitarian critics will be ready to say that European investors are earning big profits by sweating ignorant labourers who have no idea of the value of their labour. If, on the other hand, the company pays a higher wage than is current in the country where it works, it will earn for itself the dislike and resentment of local employers of labour.

Such are the difficulties which face any country that embarks in the difficult business of financing alien borrowers, unless it confines its attentions to those whose claims for the issue of further capital are unquestionable. With the best will in the world the foreign capitalist, who has only done his best to stimulate production abroad while earning a fair rate of interest for himself, is only too likely to be regarded by those who have had the use of his capital as an alien bloodsucker. It is a curious fact that commercial and industrial transactions seem to lead to much less ill-feeling than financial relations between any two parties. If we buy boots, or

any other commodities, or if we buy the use of certain services that we need, such as transport, we get the things we want, and we pay what the seller asks for them, sometimes with grumbling and hesitation, but at any rate we feel that it is a mutually satisfactory transaction or it would not have been entered into. If we buy the use of somebody else's money by promising to pay interest on it and to pay it back some day, it is almost certain that a feeling of resentment will arise sooner or later before the transaction is completed. This is probably so because we very soon forget the advantages that we secured when we got the money, whereas every interest day when we have to make a periodical payment, and every time when we have to pay back some of the capital, we are reminded very forcibly that we owe something to somebody and that we have got to pay it, and that the advantage for which we are paying is ancient history and practically forgotten.

Twenty or twenty-five years ago, when a large number of American farmers were still indebted to English mortgage companies, the unpopularity of England in America was seriously said to have been increased by this fact, although the capital acquired at the time when the advances were made had been a potent factor in the development of America's resources. So it is everywhere the lot of a creditor country to be hedged about by many disadvantages.

# CHAPTER IX

## FINANCE AND GOVERNMENT

In old times before the war the Government as a factor in finance was, in well developed and well managed countries, comparatively unimportant. A small proportion of the national income, that is, of the aggregate income of all the citizens of the country, was taken by the Government for public purposes by the process of taxation. In England, for example, where the aggregate income of the citizens was estimated before the war at somewhere between 2,000 and 2,400 millions, the total expenditure of the State amounted to less than 200 millions, the whole of which was provided by taxation and by profits on State services such as the Post Office. In fact, a small fraction of the public revenue was devoted to the redemption of the public debt, the total so redeemed in the last complete year before the war being about nine millions.

In the light of what has happened during the war and what is likely, if not certain, to happen after the war, the calls of the public purse upon the joint purse of the individuals composing the nation were thus a very small matter. Nevertheless, even in

those days, there was plenty of controversy concerning the best method by which revenue could be raised, and the balancing of the annual budget was a matter that always provoked a good deal of discussion and sometimes a certain amount of difficulty.

In this connection the duty of the Government is confined to raising all that is required for public purposes by taxation, or by loans, if loans are justified or inevitable; finance, or at least the financial machinery, as carried on by individual enterprise apart from the Government, has little or nothing to say to the matter. Since, however, it is clear that in the future very much larger revenues will have to be raised in order to meet the huge charges that will be imposed upon the nations of the world by war debts, to say nothing of heavier expenditure upon all kinds of schemes by which the economic position of the nations may or may not be benefited, it is clear that all the controversies that used to rage concerning questions of taxation will be greatly increased and embittered, and it is much to be desired that those who handle the machinery of finance should obtain clear views concerning what is and is not good policy on this subject. Hitherto they have been inclined to leave the matter to the officials concerned and have given little attention to the study of the very important questions involved. A sound public opinion on the subject of taxation and public loans is probably one of the most profitable assets that a nation can possess,

and, since financiers ought from their position and experience to be more capable than most other members of the community of arriving at sound conclusions on problems that are based on figures, it is high time for them to purge their minds of all prejudice and think these questions out, so that, when controversy arises, they may have some practical contributions to make to the stock of national wisdom.

There is no need now to enter into a historical disquisition on the growth of public sentiment concerning the right kind of taxation. It is universally admitted that the test of all taxation, the one which was embodied in Adam Smith's famous maxim on the subject, is that it should be applied in proportion to the ability of the taxpayer to meet it. In considering his question there is no need and no benefit in being sentimental and wandering into ethical doctrine. What we have to consider is, what kind of taxation will pay a nation best from the point of view of its interest of the whole.

It is at once abundantly clear that to impose any taxation upon those who are struggling on the margin of subsistence is bad policy, quite apart from any humanitarian views, from the point of view of the pockets of the other members of the community and of the nation as a whole. Those who have not enough to keep themselves strong and efficient will only, if money is taken out of their pockets by taxation, be reduced to a still lower level of incompetence and bad health, and so become

sooner or later a charge either upon the charity of their fellow citizens or upon public institutions which have to provide for the destitute. From the most entirely utilitarian and practical point of view, taxation that increases the misery of the miserable is bad for their more prosperous neighbours. If once this is granted, and anyone who is not blinded by habit and prejudice must surely grant so obvious a platitude, it is seen that all indirect taxation upon the necessaries of life is ruled out as being bad business from the point of view of the State.

For example, a tax on bread is clearly the worst kind of finance in any community in which there is any considerable number of people who are not already properly provided with food and light and clothes and housing accommodation. Thus it happens that, in communities that have arrived at anything like a reasonable state of economic development, it is not usual now to find taxes upon food imposed. It is done sometimes, as in Germany for example, where it was considered that public policy made it necessary that the landed interest should be maintained in a sufficient state of prosperity with a view to the political stability of the country, and that a number of people working on the land should still be kept in the position of comparative backwardness implied by that occupation, so that the supply of physically developed but mentally docile recruits for the army might be maintained at the required level.

Apart from political or military considerations of this kind, it will not often be found that modern States permit revenue to be raised to any great extent from the food of the people. Even when we move on from the actual necessaries of life, such as bread, to articles of common consumption, such as tea or tobacco, it is seen at once that taxation imposed upon them has the grave disadvantage of implying what economists call "inverse graduation," that is to say, it presses with a growing weight of severity upon those who are least able to bear the weight of taxation. The taxation implied by the purchase of an ounce of tobacco is the same whether the buyer be a crossing sweeper or a millionaire. The proportion of income spent upon tobacco by the crossing sweeper is very much higher than in the case of the millionaire, and the total income out of which it is paid is very much lower. Consequently taxes such as these, though they find their place in the fiscal policies of most countries, do not commend themselves on purely economic grounds.

The idea that lies behind them is that taxation is most easily collected when the man who pays it is not aware or habitually forgets that he has paid it. Anyone who buys tobacco or sugar is supposed to be deluded into the belief that all the money paid for these commodities is actually spent upon them—he does not recognise that part of it is actually spent upon the government of the country, and so he contributes readily to the government of the

country because he does not know that he is doing so.

This sort of principle in taxation may have worked well in times when statesmen were somewhat unscrupulous in the matter of imposing a burden as long as those upon whom it was placed were too ignorant to recognise it, and too ill organised to protest against it. Nevertheless, the tendency has lately been for a decrease in the proportion raised by indirect taxation and an increase in the proportion raised by direct and conscious payments on the part of the citizen, who knows perfectly well what he is paying and pays with as much cheerfulness as he can master. The greater honesty of this process is a strong recommendation in its favour, and it is fairly clear that, as the economic education of the leading nations progresses (if indeed it can yet be said to have begun), this tendency to direct and conscious taxation will continue at an accelerated pace until it is possible that in the fulness of time it will drive all others out of the field. Nevertheless there is still a very strong prejudice against direct taxation, especially on the part of those who, owing to its limited application, have to submit to indirect taxation with all the inequities of inverse graduation already described.

It has been said by Sir Robert Giffen that direct taxation produces three times as much misery as indirect. If this is so, it only shows how much has to be done to bring home to the citizen what taxation means and the best way of collecting it and

of paying it. As long as taxation is resented as a more or less unfair imposition by which a quite unsympathetic Government takes a certain amount of money out of our pockets and uses it for purposes of which we may or may not approve, it may be true that the best way to get money out of people is to take it from them in ways which leave them unconscious that they are being relieved of it. If and when a community can be discovered in which taxation is recognised as the means by which a Government, chosen by the voice of the people, acting in accordance with the will of the people, takes money from them to be spent for the good of the people, then it will perhaps be recognised that money so taken by the Goverment should and will be contributed cheerfully by the citizen and that he will not want to be bamboozled into paying it in the belief that he is buying groceries or tobacco, but that he will prefer to know exactly what he is paying and exactly how it is going to be spent.

This can only be done by the development of the raising of revenue by what are called direct taxes, that is to say, by income tax in its various forms and by death duties and legacy duties. The advantages of these taxes lie not only in their being clearly recognised when paid, but that in their case only is it possible to apply the great principle of graduation and differentiation which makes people pay more or less according to the amount of their income and the source from which it is obtained.

Taxation in proportion to ability to pay clearly

implies that those who have larger incomes should pay a higher proportion of it in taxation. If we take three incomes of £100, £1,000 and £10,000 a year, and take 10 per cent. from each, it is obvious that the sacrifice implied is not the same. The man with £100 a year pays £10, and, with prices at anything like their present level, his health and efficiency and those of his family would certainly be impaired because they would have to reduce their purchases of the necessaries of life. The man with £1,000 a year, who paid £100, would not suffer any encroachment upon his supply of necessities, but would have to curtail his supply of comforts to a very much greater extent than his richer neighbour with £10,000 a year who, having paid his £1,000, would still have £9,000 with which to control for his own use the goods and services produced by the community.

There is another still more practical argument in favour of graduation, which is that he who has more depends more upon the protection of the State than he who draws a small income. The enjoyment of a large income implies so much in the way of ordered civilisation and the protection implied by that stable organisation, that we see at once that those in enjoyment of large incomes, if that stable organisation did not provide them with the necessary security, would have to pay away a large proportion of it in keeping a private army to defend it; whereas those with small incomes, having little or nothing that is worth stealing, are not

nearly so liable to attempts by freebooters to rearrange the wealth of the world in their own interests.

And it is not only in the enjoyment of his income that the man with the large one owes more to the State and its protection. He could not even earn it if it were not for the orderly state of society which enables him to exercise his talents. It is possible that in the Middle Ages robber barons and cattle lifters and others, who took advantage of the opportunities afforded by a primitive community, may have lived upon the rest of society with a certain amount of satisfaction to themselves and in the enjoyment of the very moderate comforts that were then available. But they could not have indulged themselves with anything like the ease and comfort that are now available to those who enjoy large incomes. And they could not have imitated modern successful business men in anything like the extent of the wealth that they were able to earn by their more questionable system. Successful business men very naturally believe that they owe all that society gives them to the exercise of their talents. They do not often reflect that they could neither have acquired nor exercised these talents on a desert island, or even in an economically unorganised State. The enterprise of a modern captain of industry depends so much upon the existence of an army of producers, an army of transporters and an army of consumers, and so much on an ordered State which provides the necessary police, so that all these armies can carry out their operations un-

disturbed by anarchy and confusion, that the debt of successful earners to the State is one which fully justifies the principle of graduation in the raising of the State's revenue—that is, the principle that from those who have most shall most be taken away.

When we come to differentiation, we see again, if we remove all prejudice from our minds, that this principle also is based upon a thoroughly equitable foundation. Those who enjoy an income which they get from inherited wealth, or wealth which they have received by gift, do so without any exertion on their own part and without any of the anxiety which must haunt the salary earner, especially if he has dependents, who may be earning as much or a still greater income. A man who is earning £1,000 a year in return for hard work done and liable to be stopped at any moment if, owing to ill health or any other accident, he were deprived of his position, is earning an income, which is a very different matter from his neighbour who is receiving £1,000 a year from investments in gilt edged securities, the whole of which has been left to him by a father or an uncle or a friend.

Ability to pay in these two cases is obviously not the same. The earner is not able to pay so much because he is bound, if he is not going to become a charge on the State, to set aside every year a certain amount as a provision against ill health or old age. From the other man the limit of the amount that

can be taken would at first sight appear to be all that can maintain him in sufficient health and efficiency to lead a life of idleness. In fact, it may be contended that, from the point of view of the benefit to the owner of the income, the kindest thing to do would be to take it all away from him as long as it was done early enough in his career for him to learn how to make a living for himself. The existence of an idle rich class is not good for the community and is not good for the members of the class, if they make bad use of their opportunities. Fortunately, human nature being on the whole reasonable and well-meaning, it is out of the idle rich class that a great deal of quiet public-spirited work is done which might otherwise not be done at all. Nevertheless, the strain on the ordinary person who finds himself cursed with a competence, as the phrase says, is so great that it requires unusual strength to go through life without becoming a nuisance to himself and his neighbours.

Recognition of this fact has become very much more general since the war has set most people busy in most countries of the world, and it seems probable that taxation of estates passing by death, or of incomes acquired by inheritance, is the means by which economic progress in the direction of the better distribution of wealth will advance most rapidly in future. It is quite a common thing now to hear rich people admitting that it is not good for anybody to be born too rich. Hitherto estate duties

and differentiated income tax have been objected to, and with some reason, on the ground that, if they are screwed up too high they will tend to limit the process of accumulation on which economic progress depends. Why, it is asked, should anybody work to make a big fortune, if the State is going to take a large slice of it when he dies and then impose a highly differentiated income tax on the heirs whom he leaves to enjoy it?

This question was difficult to answer as long as many of the people who were likely to be accumulating fortunes felt like that. Taxation problems, like most economic problems, are largely psychological. If enough people who were likely to be accumulating wealth thought it unfair that their accumulation should be taxed at and after their death, such a system would certainly act as a bar to accumulation, and accumulation is, after all, the process by which people, instead of spending their money on themselves, put it at the disposal of industry to increase mankind's production. It is not a good thing to check accumulation, but, if once it is recognised that those who accumulate fortunes should and can and will do so on the same principle that other people collect stamps or blue china, and will be sufficiently satisfied by the knowledge that they are going to leave behind them a million or two at their demise—if they can be cured of the idea that they will have no satisfaction in doing so unless those who come after them are to be demoralised by the use of millions—then it is quite possible that

the principle of differentiation and a much more vigorous use of estate duties may be employed without doing any economic harm.

In the mean time, however, it is desirable that all who are interested in good financial arrangements should think out some means by which a serious blot on the Income Tax can be removed, that is to say, its application to the whole amount that a man earns or receives, irrespective of the use that he makes of the money. Whether he spends all the money on himself, or whether he puts some aside, the Income Tax levied is the same.

As has frequently been pointed out in the preceding pages, the act of saving, keen as the motive to it often is, is the only method by which capital can be provided for industry, and so the economic progress of the world can be furthered and expanded. On economic grounds there is every reason for doing everything to encourage the saver, and to penalize those who spend money especially on unsocial objects. This ideal of Income Tax levied on money spent, rather than on the total income received, has high theoretical authority, having been fathered by John Stuart Mill, approved by Professor Pigou, and now endorsed by the veteran Professor Marshall in his interesting contribution on National Finance and Taxation to a book, entitled "After War Problems."* On page 321 of this work

* London: George Allen & Unwin, Ltd.

Professor Marshall remarks as follows:—

"If it were possible to exempt from the income-tax that part of income which is saved, to become the source of future capital, while leaving property to be taxed on inheritance and in some other ways; then an income-tax graduated with preference to its amount, and the number of people who depended for their support on each income, would achieve the apparently impossible result of being a graduated tax on all personal expenditure. Rich and poor alike would be left to select those uses of their incomes which suited them best, without interference from the State, except in so far as any particular form of expenditure might be thought specially beneficial, or specially detrimental, to public interests. The income-tax would then levy the same percentage on the rich man's expenditure on coarse tea and on fine tea, on bread and on expensive food; and a higher percentage on each than on the poor man's expenditure on anything, unless it be alcohol and tobacco. The way to this ideal perfection is difficult; but it is more clearly marked than in regard to most Utopian goals."

Technical difficulties bristle in the way of such a scheme, but technical difficulties have always bristled whenever and wherever any reform of taxation is mooted. The graduation of Income Tax was long declared to be impossible and is now a commonplace of fiscal practice. In the meantime, pending the surmounting of these obstacles, it might be possible to achieve something in the same direction by a consumption tax imposed by means of a graduated receipt stamp on all purchases greater

in value than, say, £1. By this method there would be no taxation of the cheapest kinds of necessities which the poorest of the population have to buy, and when, for example, patriotic citizens try to evade taxation by making purchases of articles such as diamond necklaces on the ground that they yield no income and consequently escape Income Tax, they would pay something to the Exchequer at the time of purchase. It is obvious, however, that an impost of this kind would be easily evaded unless the public and tradesmen with whom it deals were convinced of its equity, and also that it suffers by comparison with an equitably imposed Income Tax, because it can only be graduated according to the amount of the purchase, and not according to the circumstances of the purchaser.

In all these problems of taxation a Government cannot go far ahead of the intelligence and goodwill of the community it is taxing; in fact, more usually it lags behind them and has to be pushed along by public opinion in the direction of fiscal reform. There are limits to the extent to which money can be extorted from the citizens, even the richest of them, against their will. In war time, when public opinion is acutely critical of the action of the rich, and the Government has means, by examining people's foreign correspondence and so on, of seeing what people are doing to a much greater extent than in peace, it is able to impose its will in fiscal matters much more easily. But in ordinary times the idea that the rich can be taxed

to any extent that idealist reformers think fit, without regard to the feelings of the rich, is to a great extent a mistake; even if it were possible there would come a point at which it would not pay to grow rich, and the accumulation of riches, badly as they are often used, is in fact the process by which economic progress is at present furthered, and can only be furthered until some better system is found. Consequently, it is very necessary that those who handle or own great wealth should give serious attention to these fiscal problems, recognising the claim of their poorer brethren, that if it were not for the great mass of humanity who do the rough work of the world, the accumulation and enjoyment of wealth by the rich would be impossible.

It is probable that in the next few generations very great changes will be seen in fiscal methods, and unless these changes are to be hammered out in an uncomfortable and embittered atmosphere it is high time that all classes of the community learn to take a reasonable view of the demands of government upon private purses and try to turn these demands into the only direction that justifies government in making them, that is to say, the economic betterment of the nation as a whole, through an improved production and a more equitable distribution of product.

Apart from taxation the means by which the Government provides itself with money for its needs bring it directly into contact with the machinery

of finance, because the only methods by which it can do so are by borrowing or by inflating the currency. And since the process of inflation is usually done through the machinery of finance, and borrowing on any scale has to be so carried out, finance is very much in the picture when the Government has resort to these methods; very often, in fact, the two methods go together. It might be said briefly that whenever the Government borrows directly from bankers, or indirectly from bankers by borrowing from those who borrow from their banks in order to find the money, there is an increase of currency which will not be accompanied by an increase in production, and will therefore involve inflation. For example, if, as happened in England, the Government, in times when revenue is coming in slowly, raises money by selling Treasury Bills to the Bank of England or to other banks, or by getting big credits from the Bank of England against Ways and Means advances, the effect of this is that nobody hands over buying power to the Government which he would otherwise have spent for himself, as happens when taxes are collected, but that the banking creates new money for the Government by giving it credits in its books against which it can draw cheques, which, as it pays them out to contractors and others, are paid back again into the aggregate of banking deposits, which are swelled by this process to the extent of the Government borrowing.

By this method, if we take a concrete example,

the Government places an issue of a million Treasury Bills with an English bank; the English bank's Balance Sheet is thus, for the time being, altered by its holding a million Treasury Bills instead of a million of cash at the Bank of England which it has handed over to the Government in payment of the Bills. The Government pays the million to half a dozen firms of contractors, who proceed to pay them into their accounts at the bank which lent the money, which consequently gets its money back with an increase of a million in its deposits. Its total of cash is just the same as it was before the transaction began, but it has added a million Treasury Bills to its assets, and a million deposits to its liabilities. It would not of course often happen that the contractors whom the Government paid with the million lent by this particular bank would all be its own customers, but if we could imagine that all banks in England were one, then it would be obvious that one bank would increase its deposits as fast as it increased its advances. And this does in fact happen if we take the banking figures as a whole, and consequently one of the features of British war finances has been a great increase in banking deposits, due to the use that the Government has made of the banking machinery in providing it with currency for war purposes which it had not the courage to take in taxation, or the energy and ability to charm out of the pockets of the people by successful appeals to them to lend their money.

The British Government has also, for the first time in its history, made free use of the printing press on its own account by the issue of a new kind of currency called Treasury Notes for £1 and 10/-. These notes were first issued at the time of the crisis in August, 1914, when the public and some of the banks were hoarding gold, and the only form of legal tender paper was the Bank of England note, which was not issued in denominations of less than £5. We do not yet know why the Government undertook this business of new issue instead of leaving it in the hands of the Bank of England, which could have handled it with perfect ease and elasticity, seeing that the Currency Act of 1914 suspended all restrictions on its power to issue notes. In their original form the Treasury Notes were evidently meant only to be issued as an advance to banks. This is shown by Section 2 of the Act, which says that "The amount of any Notes issued to any person shall * * * be a floating charge in priority to all other charges * * * on the assets of that person."

It is clear that notes which are to be a first charge on all the assets of the holder were only meant to be outstanding as long as the holder held them as an advance. But the Act, which was very hastily drafted and passed, did not provide that the borrower of the notes could only repay the advance in the same form in which he had borrowed, namely, by handing back the notes; and so the banks, naturally unwilling to pay the Govern-

ment interest at current Bank rate on these advances which took the form of notes, paid the Government off by draft on their balances at the Bank of England, and kept the notes still outstanding, and for a long time past it has been the custom for any English bank that wanted notes to get possession of them by paying for them with the draft on its balance at the Bank of England instead of going through the ceremony of a loan. Consequently there has been no limit to the extent to which these could be created, except the possession of a sufficient balance at the Bank of England on the part of any bank which wanted to increase its supply. And as balances at the Bank of England have been continually fed by the Government's policy in borrowing from the bank on Ways and Means advances and otherwise, and as these advances have been continually transferred from the Government's credit to that of other banks through the process described above, there has never been any lack of a balance at the Bank of England which could be turned into Treasury Notes, and so the supply of legal tender currency has continually grown.

These increases in legal tender currency, and in the right to draw cheques which is inherent in the increase of banking deposits, have unquestionably been an important cause of the rise in prices, which has done so much to increase the cost of the war in England and to embitter feeling between classes, owing to suspicions of exploitation

and profiteering on the part of those who believe that prices were being forced up by unsavoury machinations, when in fact they were being hoisted by the stupidity and timidity of politicians and officials.

The scale on which these things are done in war time enables us to see with special clearness the evil effects that they carry with them. Borrowing from bankers on Treasury Bills, or Certificates of Indebtedness, or whatever the process may be called, is a system which is only justified as a temporary measure to tide over a period in which the Government's revenue is coming in sluggishly. As soon as it is applied as a permanent part of Government finance it means inflation on a larger or smaller scale, and should be resisted as far as possible by those responsible for the financial machinery whose business it is, with their experience and practical knowledge, to correct the vagaries of official bunglers in the money market. It is commonly said that in time of war or great emergency a certain amount of inflation is inevitable because otherwise the Government cannot get the money that it wants. This argument overlooks the fact that getting the money is only part of the Government's problem. What it has to do when it is at war, or when any other causes make it necessary to take to itself a large proportion of the national production, is to get the goods. Manufacturing more money, with the help of the banks or without, if it does not increase the amount of goods available

merely gives the Government a short cut for grabbing goods on false pretences by screwing up the prices of all the goods available, and so making the community go short by reducing the buying power of the money that is left in its pocket. It is a cowardly and devious way of doing the trick, but as long as the economic education, even of the more intelligent classes of the more intelligent nations of the earth, is what it is, there is perhaps a great deal of excuse for any government that practises it in time of emergency.

The same process arises of course when the Government, instead of borrowing from banks or printing paper on its own account, borrows from subscribers to its loans, who do not hand it over saved money, but borrow from their bankers in order to produce money for patriotic purposes. In this case, unless the borrowing investor pays off his advance from his bank at least as fast as the Government pays the money out, we get an increase in currency, and a fresh tendency to inflation. The Government's problem at all times, whatever be the thing that it wants to pay for, is to make or induce the citizens to hand it over buying power which otherwise they would have spent on themselves, or have put into the development of industry. Any process which, instead of bringing this about, merely manufactures new currency, and so depreciates the value of all outstanding currency, is a fraud and a delusion which brings its punishment with it some day.

It is very necessary to lay stress on these platitudes because there has been, ever since money was invented, a tendency to believe that the lot of mankind can be made better, and that wealth can be somehow created, by a mere multiplication of the symbols which pass current and are taken in exchange of wealth. In times like these, when there are all kinds of people eager to find panaceas for all kinds of human ills, the crop of proposals for multiplying human wealth by putting into circulation an extra number of pieces of paper, is appallingly fruitful, and if such schemes are planted upon the public by politicians who have not the courage to do their financing in the right way there is great danger to the stability of the world's financial fabric.

Finally, to round off the subject one may repeat a few more platitudes, as, for instance, that when a Government borrows for any purpose that is not going to increase the power of the community to produce and transport goods, it is making a wrong use of the machinery of finance, and that when a Government borrows abroad the effect upon the national welfare is clearly worse than if it raised the money at home. If it borrows abroad and puts the money to good economic use which increases the productive power of the country, then it will have available the necessary supply of goods and services to send abroad in redemption of the debt and a balance over. If the borrowing process does not have this beneficial effect, the goods and services

that have to be sent abroad will be a direct reduction of the nation's power to consume them. If the Government borrows at home, and makes a bad or unproductive use of the money, the only result is that there is a distortion of the distribution of the national wealth. It is not necessarily diminished as a whole—though it is clearly not increased as it would have been if the money had been fruitfully invested—but those who have lent the money which has been put to a bad use are thereby given a hold, until the debt is paid, over a certain proportion of the national output, and if this process is carried too far there will be evil political and social results. It is generally assumed that by borrowing a Government can make posterity pay for whatever, by war or other enterprise, has to be financed. Whatever posterity pays it pays to itself. We cannot by any ingenuity here and now get money, still less goods and services, out of the next generation. By our loans and other financial arrangements we can gravely affect the distribution of the wealth that posterity produces, but we cannot get hold of it ourselves, and we cannot diminish it except in so far as we leave a legacy of social and political trouble which may disturb the productive effort of the nation in the future.

Summing up the effort made in this book, I have tried to show how important it is that the machinery of finance should be kept clean, and handled by men with clean hands and minds, filled always

with the wish to use it for the improvement of man's lot and the expansion of his power over the forces of Nature. Many difficulties have been shown to lie in the way of the fulfilment of the ideal, most of which are seen to arise out of the ignorance and greed of an economically uneducated public, which continually invites sharks to prey on it, and then blames finance, and those who try to work it honestly, because its invitation is accepted.

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